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This publication was prepared by the International Federation of Accountants (IFAC). Its mission is to serve the public interest, strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant.

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IFAC welcomes any comments you may have regarding this handbook. Comments may be sent to the address above or emailed to [publicsectorpubs@ifac.org](mailto:publicsectorpubs@ifac.org).

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# 2009 IFAC HANDBOOK OF INTERNATIONAL PUBLIC SECTOR ACCOUNTING PRONOUNCEMENTS

## Scope of the Handbook

This handbook brings together for continuing reference background information about the International Federation of Accountants (IFAC) and the currently effective pronouncements for the public sector issued by IFAC as of February 15, 2009.

## Volume I

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## **CHANGES OF SUBSTANCE FROM THE 2008 HANDBOOK**

### **Pronouncements Issued by the International Public Sector Accounting Standards Board**

This handbook contains references to the Public Sector Committee (the Committee, or the PSC) of IFAC. Effective November 10, 2004, the International Public Sector Accounting Standards Board (IPSASB) of IFAC replaced the PSC.

This handbook contains references to the International Auditing Practices Committee (IAPC) of IFAC. Effective April 1, 2002, the International Auditing and Assurance Standards Board (IAASB) of IFAC replaced the IAPC.

This handbook also contains references to the International Accounting Standards Committee (IASC). As of April 1, 2002, International Financial Reporting Standards (previously referred to as International Accounting Standards) are issued by the International Accounting Standards Board (IASB).

Please Note: As of this printing, the IASB Publications Department is located at 30 Cannon Street, London EC4M 6XH, United Kingdom.

E-mail: [publications@iasb.org](mailto:publications@iasb.org)

Internet: <http://www.iasb.org>

### **Pronouncements Issued by the International Ethics Standards Board for Accountants**

#### **Changes**

New paragraphs 290.14-290.26 and new or revised definitions for firm, network, and network firm, which are effective for assurance reports dated on or after December 31, 2008, have been inserted in the *Code of Ethics for Professional Accountants*. Those paragraphs that follow new paragraphs 290.14-290.26 have been renumbered accordingly.

#### **Recent Exposure Drafts**

The International Ethics Standards Board for Accountants (IESBA) has issued two exposure drafts of proposed amendments to extant Section 290 “Independence—Audit and Review Engagements” and proposed new Section 291 “Independence—Other Assurance Engagements.”

For additional information on recent developments and to obtain final pronouncements issued subsequent to December 31, 2007 or outstanding exposure drafts visit the IESBA’s page on the IFAC website at <http://www.ifac.org>.



**INTERNATIONAL PUBLIC SECTOR ACCOUNTING  
STANDARDS BOARD—INTERIM TERMS OF REFERENCE**

(Approved November 2004)

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# **INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD**

## **Interim Terms of Reference**

### **Purpose of the International Public Sector Accounting Standards Board**

1. The mission of the International Federation of Accountants (IFAC), as set out in its constitution, is “to serve the public interest, IFAC will continue to strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession’s expertise is most relevant.” In pursuing this mission, the IFAC Board has established the International Public Sector Accounting Standards Board (IPSASB) to develop high-quality accounting standards for use by public sector entities around the world in the preparation of general purpose financial statements. In this regard:
  - The term public sector refers to national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises); and
  - General purpose financial statements refers to financial statements issued for users that are unable to demand financial information to meet their specific information needs.
2. The IFAC Board has determined that designation of the IPSASB as the responsible body for the development of such standards, under its own authority and within its stated terms of reference, best serves the public interest in achieving this aspect of its mission.
3. The IPSASB functions as an independent standard-setting body under the auspices of IFAC. It achieves its objectives by:
  - Issuing International Public Sector Accounting Standards (IPSASs);
  - Promoting their acceptance and the international convergence to these standards; and
  - Publishing other documents which provide guidance on issues and experiences in financial reporting in the public sector.

## Appointment of Members

4. The members of the IPSASB are appointed by the Board of IFAC. The IPSASB comprises 18 members, 15 of whom are nominated by the member bodies of IFAC and three of whom are appointed as public members. Public members may be nominated by any individual or organization.
5. Candidates put forward are considered for appointment by the IFAC Nominating Committee. The selection process is based on the best person for the job. In recommending appointments to the Board, the Nominating Committee seeks to ensure that the IPSASB comprises a membership which possesses appropriate technical expertise, knowledge of institutional arrangements encompassed by its constituency, technical proficiencies of users, preparers and auditors, and a broad geographical spread.
6. IPSASB members are appointed for an initial term of up to three years which may be renewed for further three-year terms. Appointments will be made annually in such a way that one-third of the members shall be rotated each year. Continuous service on the Board by the same person shall be limited to two consecutive three-year terms, unless that member is appointed to serve as Chair for a further term. The members of the IPSASB will be primarily engaged in the public sector. For voting purposes, each IPSASB member has one vote.
7. Each member of the IPSASB may be joined at the meeting table by one technical advisor who will have the full privilege of the floor but will not be entitled to vote.
8. The IPSASB may appoint as observers, representatives of appropriate organizations that have a strong interest in financial reporting in the public sector, provide ongoing input to the work of the IPSASB and have an interest in endorsing and supporting IPSASs. These observers will have the privilege of the floor but will not be entitled to vote. They will be expected to possess the technical skills to participate fully in the IPSASB discussions and to attend IPSASB meetings regularly to maintain an understanding of current issues. The IPSASB will review the composition and role of observers on an annual basis.

## Nature, Scope and Authority of Pronouncements

9. The IPSASB has been given the authority, on behalf of the Board of IFAC, to issue:
  - International Public Sector Accounting Standards (IPSASs) as the standards to be applied by members of the profession in the preparation of general purpose financial statements of public sector entities. The IPSASB adopts a “due process” for the development of

IPSASs which provides all interested parties with the opportunity to provide input to the standards development process.

- Studies to provide advice on financial reporting issues in the public sector. They are based on study of the best practices and most effective methods for dealing with the issues being addressed.
- Occasional Papers and Research Reports to provide information that contributes to the body of knowledge about public sector financial reporting issues and developments. They are aimed at providing new information or fresh insights and generally result from research activities such as: literature searches, questionnaire surveys, interviews, experiments, case studies and analysis.

10. In developing its standards, the IPSASB seeks input from its Consultative Group and considers and makes use of pronouncements issued by:

- The International Accounting Standards Board (IASB) to the extent they are applicable to the public sector;
- National standard-setters, regulatory authorities and other authoritative bodies;
- Professional accounting bodies; and
- Other organizations interested in financial reporting in the public sector.

The IPSASB will ensure that its pronouncements are consistent with those of the IASB to the extent those pronouncements are applicable and appropriate to the public sector.

11. The objective of the IPSASB Consultative Group is to provide a forum in which the IPSASB can consult with representatives of different groups of constituents to obtain input and feedback on its work program, project priorities, major technical issues, due process and activities in general. The Consultative Group does not vote on International Public Sector Accounting Standards or other documents issued by the IPSASB.

12. The IPSASB cooperates with national standard-setters in preparing and issuing Standards to the extent possible, with a view to sharing resources, minimizing duplication of effort and reaching consensus and convergence in standards at an early stage in their development. It also promotes the endorsement of IPSASs by national standard-setters and other authoritative bodies and encourages debate with users, including elected and appointed representatives; Treasuries, Ministries of Finance and similar authoritative bodies; and practitioners throughout the world to identify user needs for new standards and guidance.

## Working Procedures

13. The IPSASB issues exposure drafts of all proposed standards for public comment. In some cases, the IPSASB may also issue an Invitation to Comment prior to the development of an Exposure Draft. This provides an opportunity for those affected by IPSASB pronouncements to provide input and present their views before the pronouncements are finalized and approved. The IPSASB considers all comments received on Invitations to Comment and Exposure Drafts in developing an IPSAS.
14. Each IPSASB meeting requires the presence, in person or by simultaneous telecommunications link, of at least twelve appointed members.
15. Each member of the IPSASB has one vote. An affirmative vote of at least two-thirds of the voting rights of the IPSASB is necessary to approve Invitations to Comment, Exposure Drafts and IPSASs. An IPSASB member may authorize an individual present at an IPSASB meeting to vote on behalf of the member.
16. IPSASB meetings to discuss the development, and to approve the issuance, of standards or other technical documents are open to the public. Agenda papers, including minutes of the meetings of the IPSASB, are published on the IPSASB's website.
17. IPSASB publishes an annual report outlining its work program, its activities and the progress made in achieving its objectives during the year.
18. IFAC will review the effectiveness of the IPSASB's processes at least every three years.

## Language

19. The approved text of a pronouncement is that published by IPSASB in the English language. Member bodies of IFAC are authorized to prepare, after obtaining IFAC approval, translations of such pronouncements at their own cost, to be issued in the language of their own countries as appropriate.

## INTERNATIONAL FEDERATION OF ACCOUNTANTS

### The Organization

The International Federation of Accountants (IFAC) is the global organization for the accountancy profession. Founded in 1977, its mission is “to serve the public interest, IFAC will continue to strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession’s expertise is most relevant.”

IFAC’s governing bodies, staff and volunteers are committed to the values of integrity, transparency and expertise. IFAC also seeks to reinforce professional accountants’ adherence to these values, which are reflected in the IFAC *Code of Ethics for Professional Accountants*.

For additional information on IFAC and the matters and materials described below, visit IFAC’s website at <http://www.ifac.org>.

### Primary Activities

#### Serving the Public Interest

IFAC provides leadership to the worldwide accountancy profession in serving the public interest by:

- Developing, promoting and maintaining global professional standards and a *Code of Ethics for Professional Accountants* of a consistently high quality;
- Actively encouraging convergence of professional standards, particularly, auditing, assurance, ethics, education, and public and private sector financial reporting standards;
- Seeking continuous improvements in the quality of auditing and financial management;
- Promoting the values of the accountancy profession to ensure that it continually attracts high caliber entrants;
- Promoting compliance with membership obligations; and
- Assisting developing and emerging economies, in cooperation with regional accountancy bodies and others, in establishing and maintaining a profession committed to quality performance and serving the public interest.

#### Contributing to the Efficiency of the Global Economy

IFAC contributes to the efficient functioning of the international economy by:

- Improving confidence in the quality and reliability of financial reporting;

- Encouraging the provision of high quality performance information (financial and non-financial) within organizations;
- Promoting the provision of high quality services by all members of the worldwide accountancy profession; and
- Promoting the importance of adherence to the *Code of Ethics for Professional Accountants* by all members of the accountancy profession, including members in industry, commerce, the public sector, the not-for-profit sector, academia, and public practice.

### **Providing Leadership and Spokesmanship**

IFAC is the primary spokesperson for the global profession and speaks out on a wide range of issues where the profession's expertise is most relevant. This is accomplished, in part, through outreach to numerous organizations that rely on or have an interest in the activities of the international accountancy profession. IFAC also issues policy positions on topics where the profession's expertise is most relevant. These are available from the IFAC website at <http://www.ifac.org>.

### **Membership**

IFAC is comprised of 157 members and associates in 123 countries worldwide, representing more than 2.5 million accountants in public practice, industry and commerce, the public sector, and education. No other accountancy body in the world and few other professional organizations have the broad-based international support that characterizes IFAC.

IFAC's strengths derive not only from its international representation, but also from the support and involvement of its individual member bodies, which are themselves dedicated to promoting integrity, transparency, and expertise in the accountancy profession, as well as from the support of regional accountancy bodies.

### **Standard-Setting Initiatives**

IFAC has long recognized the need for a globally harmonized framework to meet the increasingly international demands that are placed on the accountancy profession, whether from the business, the public sector or education communities. Major components of this framework are the *Code of Ethics for Professional Accountants*, International Standards on Auditing (ISAs), International Education Standards, and International Public Sector Accounting Standards (IPSASs).

IFAC's standard-setting boards, described below, follow a due process that supports the development of high quality standards in the public interest in a transparent, efficient, and effective manner. These standard-setting boards all have Consultative Advisory Groups, which provide public interest perspectives and include public members.

IFAC's Public Interest Activity Committees (PIACs) – the International Auditing and Assurance Standards Board, International Accounting Education Standards Board, International Ethics Standards Board for Accountants, and the Compliance Advisory Panel – are subject to oversight by the Public Interest Oversight Board (PIOB) (see below).

The terms of reference, due process and operating procedures of the IFAC standard-setting boards are available from the IFAC website at <http://www.ifac.org>.

IFAC actively supports convergence to ISAs and other standards developed by its independent standard-setting boards and the International Accounting Standards Board.

### **Auditing and Assurance Services**

The International Auditing and Assurance Standards Board (IAASB) develops ISAs and International Standards on Review Engagements, which deal with the audit and review of historical financial information; and International Standards on Assurance Engagements, which deal with assurance engagements other than the audit or review of historical financial information. The IAASB also develops related practice statements. These standards and statements serve as the benchmark for high quality auditing and assurance standards and statements worldwide. They establish standards and provide guidance for auditors and other professional accountants, giving them the tools to cope with the increased and changing demands for reports on financial information, and provide guidance in specialized areas.

In addition, the IAASB develops quality control standards for firms and engagement teams in the practice areas of audit, assurance and related services.

### **Ethics**

The *Code of Ethics for Professional Accountants* (the Code), developed by IFAC's International Ethics Standards Board for Accountants, establishes ethical requirements for professional accountants and provides a conceptual framework for all professional accountants to ensure compliance with the five fundamental principles of professional ethics. These principles are integrity, objectivity, professional competence and due care, confidentiality, and professional behavior. Under the framework, all professional accountants are required to identify threats to these fundamental principles and, if there are threats, apply safeguards to ensure that the principles are not compromised. A member body of IFAC or firm conducting an audit using ISAs may not apply less stringent standards than those stated in the Code.

### **Public Sector Financial Reporting**

IFAC's International Public Sector Accounting Standards Board focuses on the development of high quality financial reporting standards for use by public sector entities around the world. It has developed a comprehensive body of IPSASs setting out the requirements for financial reporting by governments and other public sector

organizations. The IPSASs represent international best practice in financial reporting by public sector entities. In many jurisdictions, the application of the requirements of IPSASs will enhance the accountability and transparency of the financial reports prepared by governments and their agencies.

The IPSASs are contained in the 2008 edition of IFAC's *Handbook of International Public Sector Accounting Pronouncements* and are also available from the IFAC website at <http://www.ifac.org>. French and Spanish translations of the 2007 IPSASs are also available for download from the IFAC website.

### **Education**

Working to advance accounting education programs worldwide, IFAC's International Accounting Education Standards Board (IAESB) develops International Education Standards, setting the benchmarks for the education of members of the accountancy profession. All member bodies are required to comply with those standards, which address the education process leading to qualification as a professional accountant as well as the ongoing continuing professional development of members of the profession. The IAESB also develops International Education Practice Statements and other guidance to assist member bodies and accounting educators in implementing and achieving best practice in accounting education.

This handbook does not contain the International Education Standards, which are available from the IFAC website at <http://www.ifac.org>.

### **Support for Professional Accountants in Business**

Both IFAC and its member bodies face the challenge of meeting the needs of an increasing number of accountants employed in business and industry, the public sector, education, and the not-for-profit sector. These accountants now comprise more than 50 percent of the membership of member bodies. IFAC's Professional Accountants in Business Committee develops guidance in collaboration with member bodies to assist in addressing a wide range of professional issues, encourages and supports high quality performance by professional accountants in business, and strives to build public awareness and understanding of the work they provide.

### **Small- and Medium-Sized Practices**

IFAC is also focused on providing support for another growing constituency: small- and medium-sized practices (SMPs). IFAC's SMP Committee develops guidance on key topics for SMPs and small- and medium-sized entities (SMEs), including implementation guidance on using ISAs in the audit of SMEs and applying International Standard on Quality Control 1. It provides input from an SMP/SME perspective on the development of international standards and on the work of the IFAC standard-setting boards. The SMP Committee also investigates ways in which

IFAC, together with its member bodies, can respond to the needs of accountants operating in SMEs and SMPs and holds annual forums on SMP/SME issues.

## **Developing Nations**

IFAC's Developing Nations Committee supports the development of the accountancy profession in all regions of the world by representing and addressing the interests of developing nations and by providing guidance to strengthen the accountancy profession worldwide. The Committee also seeks resources and development assistance from the donor community on their behalf. In addition, the Committee holds annual forums on addressing the needs of developing nations.

## **IFAC Member Body Compliance Program**

As part of the Member Body Compliance Program, IFAC members and associates (mostly national professional institutes) are required to demonstrate how they have used best endeavors, subject to national laws and regulations, to implement the standards issued by IFAC and the International Accounting Standards Board. The program, which is overseen by IFAC's Compliance Advisory Panel, also seeks to determine how members and associates have met their obligations with respect to quality assurance and investigation and disciplinary programs for their members as set out in IFAC's Statements of Membership Obligations (SMOs). As part of the Compliance Program, members and associates are required to complete a self-assessment regarding the SMO requirements and, where areas for improvement are identified, to develop action plans to address those areas. The SMOs serve as the foundation of the Compliance Program and provide clear benchmarks to current and potential member bodies to assist them in ensuring high quality performance by professional accountants.

This handbook does not contain the SMOs, which are available from the IFAC website at <http://www.ifac.org>.

## **Regulatory Framework**

In November 2003, IFAC, with the strong support of member bodies and international regulators, approved a series of reforms to increase confidence that the activities of IFAC are properly responsive to the public interest and will lead to the establishment of high quality standards and practices in auditing and assurance.

The reforms provide for the following: more transparent standard-setting processes, greater public and regulatory input into those processes, regulatory monitoring, public interest oversight, and ongoing dialogue between regulators and the accountancy profession. This is accomplished through the following structures:

***Public Interest Oversight Board (PIOB)***—Established in February 2005, the PIOB oversees IFAC's standard-setting activities in the areas of auditing and assurance, ethics (including independence) and education, as well as the IFAC Member Body

Compliance Program. The PIOB is comprised of ten representatives nominated by international regulators and institutions.

**Monitoring Group (MG)**—The MG comprises international regulators and related organizations. Its role is to update the PIOB regarding significant events in the regulatory environment. It is also the vehicle for dialogue between regulators and the international accountancy profession.

**IFAC Regulatory Liaison Group (IRLG)**—The IRLG includes the IFAC President, Deputy President, Chief Executive Officer, three members designated by the IFAC Board, the Chair of the Forum of Firms, and six others nominated by the Global Public Policy Committee. It works with the MG and addresses issues related to the regulation of the profession.

## IFAC Structure and Operations

Governance of IFAC rests with its Board and Council. The IFAC Council comprises one representative from each member body. The Board is a smaller group responsible for policy setting. As representatives of the worldwide accountancy profession, Board members sign a declaration to act with integrity and in the public interest.

The IFAC Nominating Committee makes recommendations on the composition of IFAC boards and committees, the IFAC Board, and candidates for the office of IFAC Deputy President. The committee is guided in its work by the principle of choosing the best person for the position. It also seeks to balance regional and professional representation on the boards and committees, as well as representation from countries with different levels of economic development.

IFAC is headquartered in New York City and is staffed by accounting and other professionals from around the world.

## IFAC Publications, Copyright and Translation

IFAC makes its guidance widely available by enabling individuals to freely download all publications from its website (<http://www.ifac.org>) and by encouraging its members and associates, regional accountancy bodies, standard setters, regulators and others to include links from their own websites, or print materials, to the publications on IFAC's website.

IFAC also recognizes that it is important that preparers and users of financial statements, auditors, regulators, lawyers, academia, students, and other interested groups in non-English speaking countries have access to its standards in their native language. To make its standards and guidance as widely available as possible, IFAC has developed the following policy statements that address matters related to copyright and reproduction and translation:

- *Policy for Reproducing, or Translating and Reproducing, Publications Issued by the International Federation of Accountants; and*

- *Permission to State that the International Federation of Accountants has Considered a Translating Body's Process for Translating Standards and Guidance.*

This handbook does not contain these policy statements. However, the policy statements and a database of translations of IFAC publications by third parties are available on the IFAC website at <http://www.ifac.org>.

**PREFACE TO INTERNATIONAL PUBLIC SECTOR  
ACCOUNTING STANDARDS**

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# **PREFACE TO INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS**

## **Introduction**

1. This preface to the International Public Sector Accounting Standards (IPSASs) sets out the objectives and operating procedures of the International Public Sector Accounting Standards Board (IPSASB) and explains the scope and authority of the IPSASs. The preface should be used as a reference for interpreting Invitations to Comment, discussion documents, Exposure Drafts and Standards approved and published by the IPSASB.
2. The mission of the International Federation of Accountants (IFAC), as set out in its constitution, is “to serve the public interest, strengthen the accountancy profession worldwide and contribute to the development of strong international economies by establishing and promoting adherence to high-quality professional standards, furthering the international convergence of such standards, and speaking out on public interest issues where the profession’s expertise is most relevant.” In pursuing this mission, IFAC established the IPSASB.
3. The IPSASB (formerly Public Sector Committee (PSC)) is a Board of IFAC formed to develop and issue under its own authority International Public Sector Accounting Standards (IPSASs). IPSASs are high quality global financial reporting standards for application by public sector entities other than Government Business Enterprises (GBEs).
4. The IPSASB’s Consultative Group is appointed by the IPSASB. The Consultative Group is a non-voting group. It provides a means by which the IPSASB can consult with and seek advice as necessary from a broad constituent group. The Consultative Group is chaired by the Chair of the IPSASB. The Consultative Group is primarily an electronic forum. However, regional chapters of the Consultative Group meet with the IPSASB in conjunction with any IPSASB meetings in their region. All Consultative Group members are invited to these meetings. In addition, a full meeting of all members of the Consultative Group may be held if considered necessary.

## **Objectives of the IPSASB**

5. The objectives of the IPSASB are to serve the public interest by developing high quality public sector financial reporting standards and by facilitating the convergence of international and national standards, thereby enhancing the quality and uniformity of financial reporting throughout the world. The IPSASB achieves its objectives by:
  - Issuing International Public Sector Accounting Standards (IPSASs);

- Promoting their acceptance and the international convergence to these standards; and
  - Publishing other documents which provide guidance on issues and experiences in financial reporting in the public sector.
6. The IPSASs are the authoritative requirements established by the IPSASB. Apart from developing IPSASs, the IPSASB issues other non-authoritative publications including studies, research reports and occasional papers that deal with particular public sector financial reporting issues.

#### **Membership of the IPSASB**

7. The members of the IPSASB are appointed by the IFAC Board to serve on the IPSASB. The IPSASB comprises 18 members, 15 of whom are nominated by member bodies of IFAC and three of whom are public members. Public members may be nominated by any individual or organization. In addition, a limited number of observers from bodies that have an interest in public sector financial reporting are appointed to the IPSASB. These observers have the privilege of the floor but are not entitled to vote.

#### **IPSASB Meetings**

8. Each IPSASB meeting requires a quorum of at least twelve appointed members, in person or by simultaneous telecommunications link.
9. IPSASB meetings to discuss the development and to approve the issuance of IPSASs or other papers are open to the public. Agenda papers, including the minutes of the meetings of the IPSASB, are published on the IPSASB's website: <http://www.ifac.org/publicsector>

### **Scope and Authority of International Public Sector Accounting Standards**

#### **Scope of the Standards**

10. The IPSASB develops IPSASs which apply to the accrual basis of accounting and IPSASs which apply to the cash basis of accounting.
11. IPSASs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and events in general purpose financial statements.
12. The IPSASs are designed to apply to the general purpose financial statements of all public sector entities. Public sector entities include national governments, regional governments (for example, state, provincial, territorial), local governments (for example, city, town) and their component entities (for example, departments, agencies, boards, commissions), unless otherwise stated. The Standards do not apply to GBEs. GBEs apply

International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). IPSASs include a definition of GBES.

13. Any limitation of the applicability of specific IPSASs is made clear in those standards. IPSASs are not meant to apply to immaterial items.
14. The IPSASB has adopted the policy that all paragraphs in IPSASs shall have equal authority, and that the authority of a particular provision shall be determined by the language used. To avoid any unintended consequences the IPSASB has determined to apply this policy prospectively as it reviews and reissues previously issued IPSASs. Consequently, IPSASs approved by the IPSASB after January 1, 2006 include paragraphs in bold and plain type, which have equal authority. Paragraphs in bold type indicate the main principles. An individual IPSAS should be read in the context of the objective and Basis for Conclusions (if any) stated in that IPSAS and this preface.

### **General Purpose Financial Statements**

15. Financial statements issued for users that are unable to demand financial information to meet their specific information needs are general purpose financial statements. Examples of such users are citizens, voters, their representatives and other members of the public. The term “financial statements” used in this preface and in the standards covers all statements and explanatory material which are identified as being part of the general purpose financial statements.
16. When the accrual basis of accounting underlies the preparation of the financial statements, the financial statements will include the statement of financial position, the statement of financial performance, the cash flow statement and the statement of changes in net assets/equity. When the cash basis of accounting underlies the preparation of the financial statements, the primary financial statement is the statement of cash receipts and payments.
17. In addition to preparing general purpose financial statements, an entity may prepare financial statements for other parties (such as governing bodies, the legislature and other parties who perform an oversight function) who can demand financial statements tailored to meet their specific information needs. Such statements are referred to as special purpose financial statements. The IPSASB encourages the use of IPSASs in the preparation of special purpose financial statements where appropriate.

### **IPSASs for the Accrual and Cash Bases**

18. The IPSASB develops accrual IPSASs that:
  - Are converged with International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB) by adapting them to a public sector context when appropriate.

In undertaking that process, the IPSASB attempts, wherever possible, to maintain the accounting treatment and original text of the IFRSs unless there is a significant public sector issue which warrants a departure; and

- Deals with public sector financial reporting issues that are either not comprehensively dealt with in existing IFRSs or for which IFRSs have not been developed by the IASB.
19. As many accrual based IPSASs are based on IFRSs, the IASB’s “Framework for the Preparation and Presentation of Financial Statements” is a relevant reference for users of IPSASs.
  20. The IPSASB has also issued a comprehensive Cash Basis IPSAS that includes mandatory and encouraged disclosures sections.

**Moving from the Cash Basis to the Accrual Basis**

21. The Cash Basis IPSAS encourages an entity to voluntarily disclose accrual based information, although its core financial statements will nonetheless be prepared under the cash basis of accounting. An entity in the process of moving from cash accounting to accrual accounting may wish to include particular accrual based disclosures during this process. The status (for example, audited or unaudited) and location of additional information (for example, in the notes to the financial statements or in a separate supplementary section of the financial report) will depend on the characteristics of the information (for example, reliability and completeness) and any legislation or regulations governing financial reporting within a jurisdiction.
22. The IPSASB also attempts to facilitate compliance with accrual based IPSASs through the use of transitional provisions in certain standards. Where transitional provisions exist, they may allow an entity additional time to meet the full requirements of a specific accrual based IPSAS or provide relief from certain requirements when initially applying an IPSAS. An entity may at any time elect to adopt the accrual basis of accounting in accordance with IPSASs. At this point, the entity shall apply all the accrual based IPSASs and could choose to apply any transitional provisions in an individual accrual based IPSAS.
23. Having decided to adopt accrual accounting in accordance with IPSASs, the transitional provisions would govern the length of time available to make the transition. On the expiry of the transitional provisions, the entity shall report in full in accordance with all accrual based IPSASs.
24. International Public Sector Accounting Standard (IPSAS) 1, “Presentation of Financial Statements” includes the following requirement:

An entity whose financial statements comply with International Public Sector Accounting Standards should disclose that fact.

Financial statements should not be described as complying with International Public Sector Accounting Standards unless they comply with all the requirements of each applicable International Public Sector Accounting Standard.

25. IPSAS 1 also requires disclosure of the extent to which the entity has applied any transitional provisions.

#### **Authority of International Public Sector Accounting Standards**

26. Within each jurisdiction, regulations may govern the issue of general purpose financial statements by public sector entities. These regulations may be in the form of statutory reporting requirements, financial reporting directives and instructions, and/or accounting standards promulgated by governments, regulatory bodies and/or professional accounting bodies in the jurisdiction concerned.
27. The IPSASB believes that the adoption of IPSASs, together with disclosure of compliance with them will lead to a significant improvement in the quality of general purpose financial reporting by public sector entities. This, in turn, is likely to lead to better informed assessments of the resource allocation decisions made by governments, thereby increasing transparency and accountability.
28. The IPSASB acknowledges the right of governments and national standard-setters to establish accounting standards and guidelines for financial reporting in their jurisdictions. Some sovereign governments and national standard-setters have already developed accounting standards that apply to governments and public sector entities within their jurisdiction. IPSASs may assist such standard-setters in the development of new standards or in the revision of existing standards in order to contribute to greater comparability. IPSASs are likely to be of considerable use to jurisdictions that have not yet developed accounting standards for governments and public sector entities. The IPSASB strongly encourages the adoption of IPSASs and the harmonization of national requirements with IPSASs.
29. Standing alone, neither the IPSASB nor the accounting profession has the power to require compliance with IPSASs. The success of the IPSASB's efforts is dependent upon the recognition and support for its work from many different interested groups acting within the limits of their own jurisdiction.

#### **Due Process**

30. The IPSASB adopts a due process for the development of IPSASs that provides the opportunity for comment by interested parties including IFAC member bodies, auditors, preparers (including finance ministries), standard-setters, and individuals. The IPSASB also consults with its Consultative Group on major projects, technical issues, and work program priorities.

31. The IPSASB's due process for projects normally, but not necessarily, includes the following steps:
- Study of national accounting requirements and practice and an exchange of views about the issues with national standard-setters;
  - Consideration of pronouncements issued by:
    - The International Accounting Standards Board (IASB);
    - National standard-setters, regulatory authorities and other authoritative bodies;
    - Professional accounting bodies; and
    - Other organizations interested in financial reporting in the public sector;
  - Formation of steering committees (SCs), project advisory panels (PAPs) or subcommittees to provide input to the IPSASB on a project;
  - Publication of an exposure draft for public comment usually for at least 4 months. This provides an opportunity for those affected by the IPSASB's pronouncements to present their views before the pronouncements are finalized and approved by the IPSASB. The Exposure Draft will include a Basis for Conclusion;
  - Consideration of all comments received within the comment period on discussion documents and Exposure Drafts, and to make modifications to proposed Standards as considered appropriate in the light of the IPSASB's objectives; and
  - Publication of an IPSAS which includes a Basis for Conclusions that explains the steps in the IPSASB's due process and how the IPSASB reached its conclusions.

*Steering Committees, Project Advisory Panels and Subcommittees*

32. The IPSASB may delegate the responsibility for carrying out the necessary research and for preparing Exposure Drafts of proposed Standards and guidelines or drafts of studies to SCs, subcommittees or individuals.
33. SCs, PAPs and subcommittees are chaired by a member of the IPSASB, but can include persons who are not members of the IPSASB or of a member body of IFAC.

*Approval Arrangements*

34. The draft of a standard, duly revised after the exposure period, is submitted to the IPSASB for approval. If approved by the IPSASB, it is issued as an IPSAS and becomes effective from the date specified in the Standard. On

occasion, where there are significant unresolved issues associated with an Exposure Draft, the IPSASB may decide to re-expose a proposed Standard.

35. For the purposes of approving an Invitation to Comment (ITC), ED or an IPSAS, an affirmative vote of at least two-thirds of the voting rights of the IPSASB is required. Each IPSASB member represented on the IPSASB has one vote.

### **Language**

36. The approved text of a pronouncement is that published by the IPSASB in the English language. Member bodies of IFAC are authorized to prepare, after obtaining IFAC approval, translations of such pronouncements at their own cost, to be issued in the language of their own countries as appropriate.

## **Introduction to the International Public Sector Accounting Standards**

The International Federation of Accountants' International Public Sector Accounting Standards Board (IPSASB) develops accounting standards for public sector entities referred to as International Public Sector Accounting Standards (IPSASs). The IPSASB recognizes the significant benefits of achieving consistent and comparable financial information across jurisdictions and it believes that the IPSASs will play a key role in enabling these benefits to be realized. The IPSASB strongly encourages governments and national standard-setters to engage in the development of its Standards by commenting on the proposals set out in its Exposure Drafts.

The IPSASB issues IPSASs dealing with financial reporting under the cash basis of accounting and the accrual basis of accounting. The accrual basis IPSASs are based on the International Financial Reporting Standards (IFRSs), issued by the International Accounting Standards Board (IASB) where the requirements of those Standards are applicable to the public sector. They also deal with public sector specific financial reporting issues that are not dealt with in IFRSs.

The adoption of IPSASs by governments will improve both the quality and comparability of financial information reported by public sector entities around the world. The IPSASB recognizes the right of governments and national standard-setters to establish accounting standards and guidelines for financial reporting in their jurisdictions. The IPSASB encourages the adoption of IPSASs and the harmonization of national requirements with IPSASs. Financial statements should be described as complying with IPSASs only if they comply with all the requirements of each applicable IPSAS.

## **IPSAS 1—PRESENTATION OF FINANCIAL STATEMENTS**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 1 (revised December 2003), “Presentation of Financial Statements” published by the International Accounting Standards Board (IASB). Extracts from IAS 1 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of International Accounting Standards Committee Foundation (IASCF).

The approved text of the International Financial Reporting Standards (IFRSs) is that published by IASB in the English language, and copies may be obtained directly from IASB Publications Department, 30 Cannon Street, London EC4M 6XH, United Kingdom.

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# IPSAS 1—PRESENTATION OF FINANCIAL STATEMENTS

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IPSAS 1, “Presentation of Financial Statements” (IPSAS 1) is set out in paragraphs 1–155 and Appendices A–B. All the paragraphs have equal authority. IPSAS 1 should be read in the context of its objective, the Basis for Conclusions, and the “Preface to International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

IN1. IPSAS 1, “Presentation of Financial Statements,” replaces IPSAS 1, “Presentation of Financial Statements” (issued May 2000), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

### Reasons for Revising IPSAS 1

IN2. The (IPSASB) developed this revised IPSAS 1 as a response to the (IASB’s) project on Improvement to (IASs) and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 1, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 1, “Presentation of Financial Statements” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 1 for a public sector specific reason; such variances are retained in this IPSAS 1 and are noted in the Comparison with IAS 1. Any changes to IAS 1 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 1.

### Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 1 are described below.

#### Scope

IN5. The Standard does not include requirements relating to the selection and application of accounting policies. These requirements are now included in IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.”

IN6. The Standard includes presentation requirements for surplus or deficit for the period, these requirements were previously contained in IPSAS 3.

#### Definitions

IN7. The Standard:

- Defines two new terms: impracticable and notes;
- Changes the name of term materiality to material and amends the definition;
- Removes the following unnecessary definitions: associates, borrowing costs, cash, cash equivalents, cash flows, consolidated financial statements, control, controlled entity, controlling entity, equity method, exchange difference, fair value, financial assets, foreign currency, foreign operation, minority interest, and qualifying assets. These terms

are defined in other IPSASs and are reproduced in the “Glossary of Defined Terms IPSASs 1–24; and

- Removes the following terms, which no longer exist: extraordinary items, fundamental errors, net surplus/deficit, ordinary activities, reporting currency and surplus/deficit from ordinary activities. These definitions have also been eliminated in relevant IPSASs, e.g., IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” and IPSAS 4, “The Effects of Changes in Foreign Exchange Rates.”

IN8. The Standard includes the interpretation of the term materiality and the notion of characteristics of users. Previously, IPSAS 1 did not contain this commentary.

#### **Fair Presentation and Departure from IPSASs**

IN9. The Standard clarifies that fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in the IPSASs. Previously, IPSAS 1 did not contain the guidance on the meaning of fair presentation.

IN10. The Standard requires that in the extremely rare circumstances in which management concludes that compliance with a requirement in an IPSAS would be so misleading that it would conflict with the objective of financial statements set out in IPSAS 1, departure from the requirement unless departure is prohibited by the relevant regulatory framework. In either case, the entity is required to make specified disclosures. The superseded IPSAS 1 did not set up the criterion for departure from IPSASs and did not distinguish the circumstances in which the regulatory framework permits or prohibits the departure from IPSASs.

IN11. The Standard does not include requirements related to the selection and application of accounting policies. IPSAS 3 contains such requirements. The superseded IPSAS 1 included requirements related to the selection and application of accounting policies.

#### **Classification of Assets and Liabilities**

IN12. The Standard requires that an entity uses the order of liquidity to present assets and liabilities only when a liquidity presentation provides information that is reliable and more relevant than a current/non-current presentation. The superseded IPSAS 1 did not contain such limitation.

IN13. The Standard requires that a liability held primarily for the purpose of being traded be classified as current. The superseded IPSAS 1 did not specify this criterion for liabilities classified as current.

IN14. The Standard requires that a financial liability that is due within twelve months after the reporting date, or for which the entity does not have an

unconditional right to defer its settlement for at least twelve months after the reporting date, is classified as a current liability. This classification is required even if an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting date and before the financial statements are authorized for issue. The superseded IPSAS 1 required such liabilities to be classified as non-current.

- IN15. The Standard clarifies that a liability is classified as non-current when the entity has, under the terms of an existing loan facility, the discretion to refinance or roll over its obligations for at least twelve months after the reporting date.
- IN16. The Standard requires that when a long-term financial liability is payable on demand because the entity has breached a condition of its loan agreement on or before the reporting date, the liability is classified as current at the reporting date even if, after the reporting date and before the financial statements are authorized for issue, the lender has agreed not to demand payment as a consequence of the breach. The previous version of IPSAS 1 required such liabilities to be classified as non-current.
- IN17. The Standard clarifies that the liability is classified as non-current if the lender agreed by the reporting date to provide a period of grace ending at least twelve months after the reporting date, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.

## **Presentation and Disclosure**

### *Statement of Financial Performance*

- IN18. The Standard sets out the presentation requirements for surplus or deficit for the period. These requirements were previously included in IPSAS 3.
- IN19. The Standard does not require the presentation of the following line items from the face of the statement of financial performance:
- Surplus or deficit from operating activities;
  - Surplus or deficit from ordinary activities; and
  - Extraordinary items.

The superseded IPSAS 1 required the presentation of these items.

- IN20. The Standard requires the separate presentation, on the face of the statement of financial performance, of the entity's surplus or deficit for the period allocated between: "surplus or deficit attributable to owners of the controlling entity;" and "surplus or deficit attributable to minority interest." The superseded IPSAS 1 did not contain these presentation requirements.

*Statement of Changes in Net Assets/Equity*

IN21. The Standard requires the presentation, on the face of the statement of changes in net assets/equity, of the entity's total amount of revenue and expense for the period (including amounts recognized directly in net assets/equity), showing separately the amounts attributable to minority interest and owners of the controlling entity. The superseded IPSAS 1 did not require presentation of these items.

**Notes**

IN22. The Standard requires that an entity shall disclose the judgments, apart from those involving estimations, management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognized in the financial statements (e.g., management's judgment in determining whether assets are investment properties). The superseded IPSAS 1 did not contain these disclosure requirements.

IN23. The Standard requires that an entity disclose the key assumptions concerning the future and other key sources of estimation uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. The superseded IPSAS 1 did not contain these disclosure requirements.

## IPSAS 1—PRESENTATION OF FINANCIAL STATEMENTS

### Objective

1. The objective of this Standard is to prescribe the manner in which general purpose financial statements should be presented to ensure comparability both with the entity's financial statements of previous periods and with the financial statements of other entities. To achieve this objective, this Standard sets out overall considerations for the presentation of financial statements, guidance for their structure, and minimum requirements for the content of financial statements prepared under the accrual basis of accounting. The recognition, measurement and disclosure of specific transactions and other events are dealt with in other IPSASs.

### Scope

2. **This Standard shall be applied to all general purpose financial statements prepared and presented under the accrual basis of accounting in accordance with IPSASs.**
3. General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their particular information needs. Users of general purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media, and employees. General purpose financial statements include those that are presented separately or within another public document such as an annual report. This Standard does not apply to condensed interim financial information.
4. This Standard applies equally to all entities and whether or not they need to prepare consolidated financial statements or separate financial statements, as defined in IPSAS 6, "Consolidated and Separate Financial Statements."
5. **This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).**
6. The "Preface to International Public Sector Accounting Standards" issued by the IPSASB explains that GBEs apply International Financial Reporting Standards (IFRSs) issued by the IASB. GBEs are defined in paragraph 7 below.

### Definitions

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

**Accrual basis means a basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial**

statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.

**Assets** are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

**Contributions from owners** means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:

- (a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) Can be sold, exchanged, transferred or redeemed.

**Distributions to owners** means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

**Economic entity** means a group of entities comprising a controlling entity and one or more controlled entities.

**Expenses** are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.

**Government Business Enterprise** means an entity that has all the following characteristics:

- (a) Is an entity with the power to contract in its own name;
- (b) Has been assigned the financial and operational authority to carry on a business;
- (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
- (e) Is controlled by a public sector entity.

**Impracticable** Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.

**Liabilities** are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

**Material** Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature and size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.

**Net assets/equity** is the residual interest in the assets of the entity after deducting all its liabilities.

**Notes** contain information in addition to that presented in the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement. Notes provide narrative descriptions or disaggregations of items disclosed in those statements and information about items that do not qualify for recognition in those statements.

**Revenue** is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

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

#### **Economic Entity**

8. The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.
9. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity and group.
10. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

#### **Future Economic Benefits or Service Potential**

11. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity's objectives but which do not directly generate net cash inflows are often described as

embodying service potential. Assets that are used to generate net cash inflows are often described as embodying future economic benefits. To encompass all the purposes to which assets may be put, this Standard uses the term “future economic benefits or service potential” to describe the essential characteristic of assets.

### **Government Business Enterprises**

12. GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. IPSAS 6, “Consolidated and Separate Financial Statements” provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.

### **Materiality**

13. Assessing whether an omission or misstatement could influence decisions of users, and so be material, requires consideration of the characteristics of those users. Users are assumed to have a reasonable knowledge of the public sector and economic activities and accounting and a willingness to study the information with reasonable diligence. Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making and evaluating decisions.

### **Net Assets/Equity**

14. Net assets/equity is the term used in this Standard to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

### **Purpose of Financial Statements**

15. Financial statements are a structured representation of the financial position and financial performance of an entity. The objectives of general purpose financial statements are to provide information about the financial position, financial performance and cash flows of an entity that is useful to a wide range of users in making and evaluating decisions about the allocation of resources. Specifically, the objectives of general purpose financial reporting in the public sector should be to provide information useful for decision-making, and to demonstrate the accountability of the entity for the resources entrusted to it by:

- (a) Providing information about the sources, allocation and uses of financial resources;
  - (b) Providing information about how the entity financed its activities and met its cash requirements;
  - (c) Providing information that is useful in evaluating the entity's ability to finance its activities and to meet its liabilities and commitments;
  - (d) Providing information about the financial condition of the entity and changes in it; and
  - (e) Providing aggregate information useful in evaluating the entity's performance in terms of service costs, efficiency and accomplishments.
16. General purpose financial statements can also have a predictive or prospective role, providing information useful in predicting the level of resources required for continued operations, the resources that may be generated by continued operations, and the associated risks and uncertainties. Financial reporting may also provide users with information:
- (a) Indicating whether resources were obtained and used in accordance with the legally adopted budget; and
  - (b) Indicating whether resources were obtained and used in accordance with legal and contractual requirements, including financial limits established by appropriate legislative authorities.
17. To meet these objectives, the financial statements provide information about an entity's:
- (a) Assets;
  - (b) Liabilities;
  - (c) Net assets/equity;
  - (d) Revenue;
  - (e) Expenses;
  - (f) Other changes in net assets/equity; and
  - (g) Cash flows.
18. Whilst the information contained in financial statements can be relevant for the purpose of meeting the objectives in paragraph 15, it is unlikely to enable all these objectives to be met. This is likely to be particularly so in respect of entities whose primary objective may not be to make a profit, as managers are likely to be accountable for the achievement of service delivery as well as financial objectives. Supplementary information, including non-financial statements, may be reported alongside the financial statements in order to provide a more comprehensive picture of the entity's activities during the period.

## Responsibility for Financial Statements

19. The responsibility for the preparation and presentation of financial statements varies within and across jurisdictions. In addition, a jurisdiction may draw a distinction between who is responsible for preparing the financial statements and who is responsible for approving or presenting the financial statements. Examples of people or positions who may be responsible for the preparation of the financial statements of individual entities (such as government departments or their equivalent) include the individual who heads the entity (the permanent head or chief executive) and the head of the central finance agency (or the senior finance official, such as the controller or accountant-general).
20. The responsibility for the preparation of the consolidated financial statements of the government as a whole usually rests jointly with the head of the central finance agency (or the senior finance official, such as the controller or accountant-general) and the finance minister (or equivalent).

## Components of Financial Statements

21. **A complete set of financial statements comprises:**
  - (a) **A statement of financial position;**
  - (b) **A statement of financial performance;**
  - (c) **A statement of changes in net assets/equity;**
  - (d) **A cash flow statement;**
  - (e) **When the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the financial statements; and**
  - (f) **Notes, comprising a summary of significant accounting policies and other explanatory notes.**
22. The components listed in paragraph 21 are referred to by a variety of names both within and across jurisdictions. The statement of financial position may also be referred to as a balance sheet or statement of assets and liabilities. The statement of financial performance may also be referred to as a statement of revenues and expenses, an income statement, an operating statement, or a profit and loss statement. The notes may include items referred to as schedules in some jurisdictions.
23. The financial statements provide users with information about an entity's resources and obligations at the reporting date and the flow of resources between reporting dates. This information is useful for users making assessments of an entity's ability to continue to provide goods and services at a given level, and the

level of resources that may need to be provided to the entity in the future so that it can continue to meet its service delivery obligations.

24. Public sector entities are typically subject to budgetary limits in the form of appropriations or budget authorizations (or equivalent), which may be given effect through authorizing legislation. General purpose financial reporting by public sector entities may provide information on whether resources were obtained and used in accordance with the legally adopted budget. Entities which make publicly available their approved budget(s) are required to comply with the requirements of IPSAS 24, "Presentation of Budget Information in Financial Statements." For other entities, where the financial statements and the budget are on the same basis of accounting, this Standard encourages the inclusion in the financial statements of a comparison with the budgeted amounts for the reporting period. Reporting against budget(s) for these entities may be presented in various different ways, including:
  - (a) The use of a columnar format for the financial statements, with separate columns for budgeted amounts and actual amounts. A column showing any variances from the budget or appropriation may also be presented, for completeness; and
  - (b) Disclosure that the budgeted amounts have not been exceeded. If any budgeted amounts or appropriations have been exceeded, or expenses incurred without appropriation or other form of authority, then details may be disclosed by way of footnote to the relevant item in the financial statements.
25. Entities are encouraged to present additional information to assist users in assessing the performance of the entity, and its stewardship of assets, as well as making and evaluating decisions about the allocation of resources. This additional information may include details about the entity's outputs and outcomes in the form of performance indicators, statements of service performance, program reviews and other reports by management about the entity's achievements over the reporting period.
26. Entities are also encouraged to disclose information about compliance with legislative, regulatory or other externally-imposed regulations. When information about compliance is not included in the financial statements, it may be useful for a note to refer to any documents that include that information. Knowledge of non-compliance is likely to be relevant for accountability purposes and may affect a user's assessment of the entity's performance and direction of future operations. It may also influence decisions about resources to be allocated to the entity in the future.

## Overall Considerations

### Fair Presentation and Compliance with IPSASs

27. **Financial statements shall present fairly the financial position, financial performance and cash flows of an entity. Fair presentation requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, revenue and expenses set out in IPSASs. The application of IPSASs, with additional disclosures when necessary, is presumed to result in financial statements that achieve a fair presentation.**
28. **An entity whose financial statements comply with IPSASs shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with IPSASs unless they comply with all the requirements of IPSASs.**
29. In virtually all circumstances, a fair presentation is achieved by compliance with applicable IPSASs. A fair presentation also requires an entity:
  - (a) To select and apply accounting policies in accordance with IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.” IPSAS 3 sets out a hierarchy of authoritative guidance that management considers in the absence of a Standard that specifically applies to an item.
  - (b) To present information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information.
  - (c) To provide additional disclosures when compliance with the specific requirements in IPSASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance.
30. **Inappropriate accounting policies are not rectified either by disclosure of the accounting policies used, or by notes or explanatory material.**
31. **In the extremely rare circumstances in which management concludes that compliance with a requirement in a Standard would be so misleading that it would conflict with the objective of financial statements set out in this IPSAS, the entity shall depart from that requirement in the manner set out in paragraph 32 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.**
32. **When an entity departs from a requirement of a Standard in accordance with paragraph 31, it shall disclose:**
  - (a) **That management has concluded that the financial statements present fairly the entity’s financial position, financial performance and cash flows;**

- (b) **That it has complied with applicable IPSASs, except that it has departed from a particular requirement to achieve a fair presentation;**
  - (c) **The title of the Standard from which the entity has departed, the nature of the departure, including the treatment that the Standard would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in this IPSAS, and the treatment adopted; and**
  - (d) **For each period presented, the financial impact of the departure on each item in the financial statements that would have been reported in complying with the requirement.**
33. **When an entity has departed from a requirement of a Standard in a prior period, and that departure affects the amounts recognized in the financial statements for the current period, it shall make the disclosures set out in paragraph 32(c) and (d).**
34. Paragraph 33 applies, for example, when an entity departed in a prior period from a requirement in a Standard for the measurement of assets or liabilities and that departure affects the measurement of changes in assets and liabilities recognized in the current period's financial statements.
35. **In the extremely rare circumstances in which management concludes that compliance with a requirement in a Standard would be so misleading that it would conflict with the objective of financial statements set out in this IPSAS, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:**
- (a) **The title of the Standard in question, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in this IPSAS; and**
  - (b) **For each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.**
36. For the purpose of paragraphs 31–35, an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions, other events and conditions that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to influence decisions made by users of financial statements. When assessing whether complying with a specific requirement in a Standard would

be so misleading that it would conflict with the objective of financial statements set out in this IPSAS, management considers:

- (a) Why the objective of financial statements is not achieved in the particular circumstances; and
- (b) How the entity's circumstances differ from those of other entities that comply with the requirement. If other entities in similar circumstances comply with the requirement, there is a rebuttable presumption that the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of the financial statements set out in this IPSAS.

37. Departures from the requirements of an IPSAS in order to comply with statutory/legislative financial reporting requirements in a particular jurisdiction do not constitute departures that conflict with the objective of financial statements set out in this IPSAS as outlined in paragraph 31. If such departures are material an entity cannot claim to be complying with IPSASs.

### Going Concern

38. **When preparing financial statements an assessment of an entity's ability to continue as a going concern shall be made. This assessment shall be made by those responsible for the preparation of financial statements. Financial statements shall be prepared on a going concern basis unless there is an intention to liquidate the entity or to cease operating, or if there is no realistic alternative but to do so. When those responsible for the preparation of the financial statements are aware, in making their assessment, of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, those uncertainties shall be disclosed. When financial statements are not prepared on a going concern basis, that fact shall be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not regarded as a going concern.**
39. Financial statements are normally prepared on the assumption that the entity is a going concern and will continue in operation and meet its statutory obligations for the foreseeable future. In assessing whether the going concern assumption is appropriate, those responsible for the preparation of financial statements take into account all available information about the future, which is at least, but is not limited to, twelve months from the approval of the financial statements.
40. The degree of consideration depends on the facts in each case, and assessments of the going concern assumption are not predicated on the solvency test usually applied to business enterprises. There may be circumstances where the usual going concern tests of liquidity and solvency

appear unfavorable, but other factors suggest that the entity is nonetheless a going concern. For example:

- (a) In assessing whether a government is a going concern, the power to levy rates or taxes may enable some entities to be considered as a going concern even though they may operate for extended periods with negative net assets/equity; and
- (b) For an individual entity, an assessment of its statement of financial position at the reporting date may suggest that the going concern assumption is not appropriate. However, there may be multi-year funding agreements, or other arrangements, in place that will ensure the continued operation of the entity.

41. The determination of whether the going concern assumption is appropriate is primarily relevant for individual entities rather than for a government as a whole. For individual entities, in assessing whether the going concern basis is appropriate, those responsible for the preparation of financial statements may need to consider a wide range of factors relating to current and expected performance, potential and announced restructurings of organizational units, estimates of revenue or the likelihood of continued government funding, and potential sources of replacement financing before it is appropriate to conclude that the going concern assumption is appropriate.

#### **Consistency of Presentation**

42. **The presentation and classification of items in the financial statements shall be retained from one period to the next unless:**
- (a) **It is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of accounting policies in IPSAS 3; or**
  - (b) **An IPSAS requires a change in presentation.**
43. A significant acquisition or disposal, or a review of the presentation of the financial statements, might suggest that the financial statements need to be presented differently. For example, an entity may dispose of a savings bank that represents one of its most significant controlled entities and the remaining economic entity conducts mainly administrative and policy advice services. In this case, the presentation of the financial statements based on the principal activities of the economic entity as a financial institution is unlikely to be relevant for the new economic entity.
44. An entity changes the presentation of its financial statements only if the changed presentation provides information that is reliable and is more relevant to users of the financial statements and the revised structure is likely to

continue, so that comparability is not impaired. When making such changes in presentation, an entity reclassifies its comparative information in accordance with paragraph 55 and 56.

### **Materiality and Aggregation**

45. **Each material class of similar items shall be presented separately in the financial statements. Items of a dissimilar nature or function shall be presented separately unless they are immaterial.**
46. Financial statements result from processing large numbers of transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement, or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of those statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of those statements may nevertheless be sufficiently material for it to be presented separately in the notes.
47. Applying the concept of materiality means that a specific disclosure requirement in an IPSAS need not be satisfied if the information is not material.

### **Offsetting**

48. **Assets and liabilities, and revenue and expenses, shall not be offset unless required or permitted by an IPSAS.**
49. It is important that assets and liabilities, and revenue and expenses, are reported separately. Offsetting in the statement of financial performance or the statement of financial position, except when offsetting reflects the substance of the transaction or other event, detracts from the ability of users both to understand the transactions, other events and conditions that have occurred and to assess the entity's future cash flows. Measuring assets net of valuation allowances – for example, obsolescence allowances on inventories and doubtful debts allowances on receivables – is not offsetting.
50. IPSAS 9, "Revenue from Exchange Transactions" defines revenue and requires it to be measured at the fair value of consideration received or receivable, taking into account the amount of any trade discounts and volume rebates allowed by the entity. An entity undertakes, in the course of its ordinary activities, other transactions that do not generate revenue but are incidental to the main revenue-generating activities. The results of such transactions are presented, when this presentation reflects the substance of the transaction or other event, by netting any revenue with related expenses arising on the same transaction. For example:

- (a) Gains and losses on the disposal of non-current assets, including investments and operating assets, are reported by deducting from the proceeds on disposal the carrying amount of the asset and related selling expenses; and
  - (b) Expenses related to a provision that is recognized in accordance with IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets” and reimbursed under a contractual arrangement with a third party (for example, a supplier’s warranty agreement) may be netted against the related reimbursement.
51. In addition, gains and losses arising from a group of similar transactions are reported on a net basis, for example, foreign exchange gains and losses and gains and losses arising on financial instruments held for trading. Such gains and losses are, however, reported separately if they are material.
52. The offsetting of cash flows is dealt with in IPSAS 2, “Cash Flow Statements.”

### **Comparative Information**

53. **Except when an IPSAS permits or requires otherwise, comparative information shall be disclosed in respect of the previous period for all amounts reported in the financial statements. Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period’s financial statements.**
54. In some cases, narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last reporting date and is yet to be resolved, are disclosed in the current period. Users benefit from information that the uncertainty existed at the last reporting date, and about the steps that have been taken during the period to resolve the uncertainty.
55. **When the presentation or classification of items in the financial statements is amended, comparative amounts shall be reclassified unless the reclassification is impracticable. When comparative amounts are reclassified, an entity shall disclose:**
- (a) **The nature of the reclassification;**
  - (b) **The amount of each item or class of items that is reclassified; and**
  - (c) **The reason for the reclassification.**
56. **When it is impracticable to reclassify comparative amounts, an entity shall disclose:**
- (a) The reason for not reclassifying the amounts; and

- (b) The nature of the adjustments that would have been made if the amounts had been reclassified.
57. Enhancing the inter-period comparability of information assists users in making and evaluating decisions, especially by allowing the assessment of trends in financial information for predictive purposes. In some circumstances, it is impracticable to reclassify comparative information for a particular prior period to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows reclassification, and it may not be practicable to recreate the information.
  58. IPSAS 3 deals with the adjustments to comparative information required when an entity changes an accounting policy or corrects an error.

## Structure and Content

### Introduction

59. This Standard requires particular disclosures on the face of the statement of financial position, statement of financial performance and statement of changes in net assets/equity and requires disclosure of other line items either on the face of those statements or in the notes. IPSAS 2 sets out requirements for the presentation of a cash flow statement.
60. This Standard sometimes uses the term disclosure in a broad sense, encompassing items presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement, as well as in the notes. Disclosures are also required by other IPSASs. Unless specified to the contrary elsewhere in this Standard, or in another Standard, such disclosures are made either on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement (whichever is relevant), or in the notes. w

### Identification of the Financial Statements

61. **The financial statements shall be identified clearly and distinguished from other information in the same published document.**
62. IPSASs apply only to financial statements, and not to other information presented in an annual report or other document. Therefore, it is important that users can distinguish information that is prepared using IPSASs from other information that may be useful to users but is not the subject of those requirements.
63. **Each component of the financial statements shall be identified clearly. In addition, the following information shall be displayed prominently, and repeated when it is necessary for a proper understanding of the information presented:**

- (a) **The name of the reporting entity or other means of identification and any change in that information from the preceding reporting date;**
  - (b) **Whether the financial statements cover the individual entity or the economic entity;**
  - (c) **The reporting date or the period covered by the financial statements, whichever is appropriate to that component of the financial statements;**
  - (d) **The presentation currency, as defined in IPSAS 4, “The Effects of Changes in Foreign Exchange Rates;” and**
  - (e) **The level of rounding used in presenting amounts in the financial statements.**
64. The requirements in paragraph 63 are normally met by presenting page headings and abbreviated column headings on each page of the financial statements. Judgment is required in determining the best way of presenting such information. For example, when the financial statements are presented electronically, separate pages are not always used; the above items are then presented frequently enough to ensure a proper understanding of the information included in the financial statements.
65. Financial statements are often made more understandable by presenting information in thousands or millions of units of the presentation currency. This is acceptable as long as the level of rounding in presentation is disclosed and material information is not omitted.

#### **Reporting Period**

66. **Financial statements shall be presented at least annually. When an entity’s reporting date changes and the annual financial statements are presented for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:**
- (a) **The reason for using a longer or shorter period; and**
  - (b) **The fact that comparative amounts for certain statements such as the statement of financial performance, statement of changes in net assets/equity, cash flow statement and related notes are not entirely comparable.**
67. In exceptional circumstances an entity may be required to, or decide to, change its reporting date, for example in order to align the reporting cycle more closely with the budgeting cycle. When this is the case, it is important that users are aware that the amounts shown for the current period and comparative amounts are not comparable and that the reason for the change in reporting date is disclosed. A further example is where, in making the

transition from cash to accrual accounting, an entity changes the reporting date for entities within the economic entity to enable the preparation of consolidated financial statements.

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

### Timeliness

69. The usefulness of financial statements is impaired if they are not made available to users within a reasonable period after the reporting date. An entity should be in a position to issue its financial statements within six months of the reporting date. Ongoing factors such as the complexity of an entity's operations are not sufficient reason for failing to report on a timely basis. More specific deadlines are dealt with by legislation and regulations in many jurisdictions.

### Statement of Financial Position

#### *Current/Non-current Distinction*

70. **An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its statement of financial position in accordance with paragraphs 76–87 except when a presentation based on liquidity provides information that is reliable and is more relevant. When that exception applies, all assets and liabilities shall be presented broadly in order of liquidity.**
71. **Whichever method of presentation is adopted, for each asset and liability line item that combines amounts expected to be recovered or settled (a) no more than twelve months after the reporting date and (b) more than twelve months after the reporting date, an entity shall disclose the amount expected to be recovered or settled after more than twelve months.**
72. When an entity supplies goods or services within a clearly identifiable operating cycle, separate classification of current and non-current assets and liabilities on the face of the statement of financial position provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the entity's long-term operations. It also highlights assets that are expected to be realized within the current operating cycle, and liabilities that are due for settlement within the same period.
73. For some entities, such as financial institutions, a presentation of assets and liabilities in increasing or decreasing order of liquidity provides information that is reliable and is more relevant than a current/non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.

74. In applying paragraph 70, an entity is permitted to present some of its assets and liabilities using a current/non-current classification and others in order of liquidity when this provides information that is reliable and is more relevant. The need for a mixed basis of presentation might arise when an entity has diverse operations.
75. Information about expected dates of realization of assets and liabilities is useful in assessing the liquidity and solvency of an entity. IPSAS 15, “Financial Instruments: Disclosure and Presentation” requires disclosure of the maturity dates of financial assets and financial liabilities. Financial assets include trade and other receivables, and financial liabilities include trade and other payables. Information on the expected date of recovery and settlement of non-monetary assets and liabilities such as inventories and provisions is also useful, whether or not assets and liabilities are classified as current or non-current.

*Current Assets*

76. **An asset shall be classified as current when it satisfies any of the following criteria:**
- (a) **It is expected to be realized in, or is held for sale or consumption in, the entity’s normal operating cycle;**
  - (b) **It is held primarily for the purpose of being traded;**
  - (c) **It is expected to be realized within twelve months after the reporting date; or**
  - (d) **It is cash or a cash equivalent (as defined in IPSAS 2, unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the reporting date.**

**All other assets shall be classified as non-current.**

77. This Standard uses the term non-current assets to include tangible, intangible and financial assets of a long-term nature. It does not prohibit the use of alternative descriptions as long as the meaning is clear.
78. The operating cycle of an entity is the time taken to convert inputs or resources into outputs. For instance, governments transfer resources to public sector entities so that they can convert those resources into goods and services, or outputs, to meet the government’s desired social, political and economic outcomes. When the entity’s normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.
79. Current assets include assets (such as taxes receivable, user charges receivable, fines and regulatory fees receivable, inventories and accrued investment revenue) that are either realized, consumed or sold, as part of the normal operating cycle even when they are not expected to be realized within twelve

months after the reporting date. Current assets also include assets held primarily for the purpose of being traded (guidance on classification of financial assets can be found in the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments) and the current portion of non-current financial assets.

*Current Liabilities*

80. **A liability shall be classified as current when it satisfies any of the following criteria:**

- (a) **It is expected to be settled in the entity's normal operating cycle;**
- (b) **It is held primarily for the purpose of being traded;**
- (c) **It is due to be settled within twelve months after the reporting date; or**
- (d) **The entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the reporting date.**

**All other liabilities shall be classified as non-current.**

81. Some current liabilities, such as government transfers payable and some accruals for employee and other operating costs, are part of the working capital used in the entity's normal operating cycle. Such operating items are classified as current liabilities even if they are due to be settled more than twelve months after the reporting date. The same normal operating cycle applies to the classification of an entity's assets and liabilities. When the entity's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.

82. Other current liabilities are not settled as part of the normal operating cycle, but are due for settlement within twelve months after the reporting date or held primarily for the purpose of being traded. Examples are financial liabilities classified held for trading (guidance on classification of financial liabilities can be found in the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments), bank overdrafts, and the current portion of non-current financial liabilities, dividends payable, income taxes and other non-trade payables. Financial liabilities that provide financing on a long-term basis (i.e., are not part of the working capital used in the entity's normal operating cycle) and are not due for settlement within twelve months after the reporting date are non-current liabilities, subject to paragraphs 85 and 86.

83. An entity classifies its financial liabilities as current when they are due to be settled within twelve months after the reporting date, even if:

- (a) The original term was for a period longer than twelve months; and

- (b) An agreement to refinance, or to reschedule payments, on a long-term basis is completed after the reporting date and before the financial statements are authorized for issue.
84. If an entity expects, and has the discretion, to refinance or roll over an obligation for at least twelve months after the reporting date under an existing loan facility, it classifies the obligation as non-current, even if it would otherwise be due within a shorter period. However, when refinancing or rolling over the obligation is not at the discretion of the entity (for example, there is no agreement to refinance), the potential to refinance is not considered and the obligation is classified as current.
85. When an entity breaches an undertaking under a long-term loan agreement on or before the reporting date with the effect that the liability becomes payable on demand, the liability is classified as current, even if the lender has agreed, after the reporting date and before the authorization of the financial statements for issue, not to demand payment as a consequence of the breach. The liability is classified as current because, at the reporting date, the entity does not have an unconditional right to defer its settlement for at least twelve months after that date.
86. However, the liability is classified as non-current if the lender agreed by the reporting date to provide a period of grace ending at least twelve months after the reporting date, within which the entity can rectify the breach and during which the lender cannot demand immediate repayment.
87. In respect of loans classified as current liabilities, if the following events occur between the reporting date and the date the financial statements are authorized for issue, those events qualify for disclosure as non-adjusting events in accordance with IPSAS 14, “Events after the Reporting Date”:
- (a) Refinancing on a long-term basis;
  - (b) Rectification of a breach of a long-term loan agreement; and
  - (c) The receipt from the lender of a period of grace to rectify a breach of a long-term loan agreement ending at least twelve months after the reporting date.

*Information to be Presented on the Face of the Statement of Financial Position*

88. **As a minimum, the face of the statement of financial position shall include line items that present the following amounts:**
- (a) **Property, plant and equipment;**
  - (b) **Investment property;**
  - (c) **Intangible assets;**
  - (d) **Financial assets (excluding amounts shown under (e), (g), (h) and (i));**

- (e) **Investments accounted for using the equity method;**
  - (f) **Inventories;**
  - (g) **Recoverables from non-exchange transactions (taxes and transfers);**
  - (h) **Receivables from exchange transactions;**
  - (i) **Cash and cash equivalents;**
  - (j) **Taxes and transfers payable;**
  - (k) **Payables under exchange transactions;**
  - (l) **Provisions;**
  - (m) **Financial liabilities (excluding amounts shown under (j), (k) and (l));**
  - (n) **Minority interest, presented within net assets/equity; and**
  - (o) **Net assets/equity attributable to owners of the controlling entity.**
89. **Additional line items, headings and sub-totals shall be presented on the face of the statement of financial position when such presentation is relevant to an understanding of the entity's financial position.**
90. This Standard does not prescribe the order or format in which items are to be presented. Paragraph 88 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation on the face of the statement of financial position. Illustrative formats are set out in Implementation Guidance to this Standard. In addition:
- (a) Line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and
  - (b) The descriptions used and the ordering of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position.
91. The judgment on whether additional items are presented separately is based on an assessment of:
- (a) The nature and liquidity of assets;
  - (b) The function of assets within the entity; and
  - (c) The amounts, nature and timing of liabilities.
92. The use of different measurement bases for different classes of assets suggests that their nature or function differs and, therefore, that they should be

presented as separate line items. For example, different classes of property, plant and equipment can be carried at cost or revalued amounts in accordance with IPSAS 17, “Property, Plant and Equipment.”

*Information to be Presented either on the Face of the Statement of Financial Position or in the Notes*

93. **An entity shall disclose, either on the face of the statement of financial position or in the notes, further subclassifications of the line items presented, classified in a manner appropriate to the entity’s operations.**
94. The detail provided in subclassifications depends on the requirements of IPSASs and on the size, nature and function of the amounts involved. The factors set out in paragraph 91 also are used to decide the basis of subclassification. The disclosures vary for each item, for example:
- (a) Items of property, plant and equipment are disaggregated into classes in accordance with IPSAS 17;
  - (b) Receivables are disaggregated into amounts receivable from user charges, taxes and other non-exchange revenues, receivables from related parties, prepayments and other amounts;
  - (c) Inventories are subclassified in accordance with IPSAS 12, “Inventories,” into classifications such as merchandise, production supplies, materials, work in progress and finished goods;
  - (d) Taxes and transfers payable are disaggregated into tax refunds payable, transfers payable, and amounts payable to other members of the economic entity;
  - (e) Provisions are disaggregated into provisions for employee benefits and other items; and
  - (f) Components of net assets/equity are disaggregated into contributed capital, accumulated surpluses and deficits and any reserves.
95. **When an entity has no share capital, it shall disclose net assets/equity, either on the face of the statement of financial position or in the notes, showing separately:**
- (a) **Contributed capital, being the cumulative total at the reporting date of contributions from owners, less distributions to owners;**
  - (b) **Accumulated surpluses or deficits;**
  - (c) **Reserves, including a description of the nature and purpose of each reserve within net assets/equity; and**
  - (d) **Minority interests.**
96. Many public sector entities will not have share capital but the entity will be controlled exclusively by another public sector entity. The nature of the

government's interest in the net assets/equity of the entity is likely to be a combination of contributed capital and the aggregate of the entity's accumulated surpluses or deficits and reserves that reflect the net assets/equity attributable to the entity's operations.

97. In some cases, there may be a minority interest in the net assets/equity of the entity. For example, at whole-of-government level, the economic entity may include a GBE that has been partly privatized. Accordingly, there may be private shareholders who have a financial interest in the net assets/equity of the entity.
98. **When an entity has share capital, in addition to the disclosures in paragraph 95, it shall disclose the following, either on the face of the statement of financial position or in the notes:**
- (a) **For each class of share capital:**
    - (i) **The number of shares authorized;**
    - (ii) **The number of shares issued and fully paid, and issued but not fully paid;**
    - (iii) **Par value per share, or that the shares have no par value;**
    - (iv) **A reconciliation of the number of shares outstanding at the beginning and at the end of the year;**
    - (v) **The rights, preferences and restrictions attaching to that class, including restrictions on the distribution of dividends and the repayment of capital;**
    - (vi) **Shares in the entity held by the entity or by its controlled entities or associates; and**
    - (vii) **Shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts; and**
  - (b) **A description of the nature and purpose of each reserve within net assets/equity.**

#### **Statement of Financial Performance**

##### *Surplus or Deficit for the Period*

99. **All items of revenue and expense recognized in a period shall be included in surplus or deficit unless an IPSAS requires otherwise.**
100. Normally, all items of revenue and expense recognized in a period are included in surplus or deficit. This includes the effects of changes in accounting estimates. However, circumstances may exist when particular items may be excluded from surplus or deficit for the current period. IPSAS 3 deals with two such circumstances: the correction of errors and the effect of changes in accounting policies.

101. Other Standards deal with items that may meet definitions of revenue or expense set out in this IPSAS but are usually excluded from surplus or deficit. Examples include revaluation surpluses (see IPSAS 17), particular gains and losses arising on translating the financial statements of a foreign operation (see IPSAS 4) and gains or losses on remeasuring available-for-sale financial assets (guidance on measurement of financial assets can be found in the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments).

*Information to be Presented on the Face of the Statement of Financial Performance*

102. **As a minimum, the face of the statement of financial performance shall include line items that present the following amounts for the period:**
- (a) **Revenue;**
  - (b) **Finance costs;**
  - (c) **Share of the surplus or deficit of associates and joint ventures accounted for using the equity method;**
  - (d) **Pre-tax gain or loss recognized on the disposal of assets or settlement of liabilities attributable to discontinuing operations; and**
  - (e) **Surplus or deficit.**
103. **The following items shall be disclosed on the face of the statement of financial performance as allocations of surplus or deficit for the period:**
- (a) **Surplus or deficit attributable to minority interest; and**
  - (b) **Surplus or deficit attributable to owners of the controlling entity.**
104. **Additional line items, headings and subtotals shall be presented on the face of the statement of financial performance when such presentation is relevant to an understanding of the entity's financial performance.**
105. Because the effects of an entity's various activities, transactions and other events differ in terms of their impact on its ability to meet its service delivery obligations, and disclosing the components of financial performance assists in an understanding of the financial performance achieved and in making projections of future results. Additional line items are included on the face of the statement of financial performance, and the descriptions used and the ordering of items are amended when this is necessary to explain the elements of performance. Factors to be considered include materiality and the nature and function of the components of revenue and expenses. Revenue and expense items are not offset unless the criteria in paragraph 48 are met.

*Information to be Presented either on the Face of the Statement of Financial Performance or in the Notes*

106. **When items of revenue and expense are material, their nature and amount shall be disclosed separately.**
107. Circumstances that would give rise to the separate disclosure of items of revenue and expense include:
- (a) Write-downs of inventories to net realizable value or of property, plant and equipment to recoverable amount or recoverable service amount as appropriate, as well as reversals of such write-downs;
  - (b) Restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
  - (c) Disposals of items of property, plant and equipment;
  - (d) Privatizations or other disposals of investments;
  - (e) Discontinuing operations;
  - (f) Litigation settlements; and
  - (g) Other reversals of provisions.
108. **An entity shall present, either on the face of the statement of financial performance or in the notes, a subclassification of total revenue, classified in a manner appropriate to the entity's operations.**
109. **An entity shall present, either on the face of the statement of financial performance or in the notes, an analysis of expenses using a classification based on either the nature of expenses or their function within the entity, whichever provides information that is reliable and more relevant.**
110. Entities are encouraged to present the analysis in paragraph 109 on the face of the statement of financial performance.
111. Expenses are subclassified to highlight the costs and cost recoveries of particular programs, activities or other relevant segments of the reporting entity. This analysis is provided in one of two ways.
112. The first form of analysis is the nature of expense method. Expenses are aggregated in the statement of financial performance according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits and advertising costs), and are not reallocated among various functions within the entity. This method may be simple to apply because no allocations of expenses to functional classifications are necessary. An example of a classification using the nature of expense method is as follows:

Revenue		X
Employee benefits costs	X	
Depreciation and amortization expense	X	
Other expenses	<u>X</u>	
Total expenses		<u>(X)</u>
Surplus		<u><u>X</u></u>

113. The second form of analysis is the function of expense method and classifies expenses according to the program or purpose for which they were made. This method can provide more relevant information to users than the classification of expenses by nature, but allocating costs to functions may require arbitrary allocations and involves considerable judgment. An example of a classification using the function of expense method is as follows:

Revenue		X
Expenses:		
Health expenses		(X)
Education expenses		(X)
Other expenses		<u>(X)</u>
Surplus		<u><u>X</u></u>

114. The expenses associated with the main functions undertaken by the entity are shown separately. In this example, the entity has functions relating to the provision of health and education services. The entity would present expense line items for each of these functions.
115. **Entities classifying expenses by function shall disclose additional information on the nature of expenses, including depreciation and amortization expense and employee benefits expense.**
116. The choice between the function of expense method and the nature of expense method depends on historical and regulatory factors and the nature of the entity. Both methods provide an indication of those costs that might vary, directly or indirectly, with the outputs of the entity. Because each method of presentation has its merits for different types of entities, this Standard requires management to select the most relevant and reliable presentation. However, because information on the nature of expenses is useful in predicting future cash flows, additional disclosure is required when the function of expense

classification is used. In paragraph 115, employee benefits has the same meaning as in IPSAS 26, “Employee Benefits.”

117. **When an entity provides a dividend or similar distribution to its owners and has share capital, it shall disclose, either on the face of the statement of financial performance or the statement of changes in net assets/equity, or in the notes, the amount of dividends or similar distributions recognized as distributions to owners during the period, and the related amount per share.**

#### **Statement of Changes in Net Assets/Equity**

118. **An entity shall present a statement of changes in net assets/equity showing on the face of the statement:**
- (a) **Surplus or deficit for the period;**
  - (b) **Each item of revenue and expense for the period that, as required by other Standards, is recognized directly in net assets/equity, and the total of these items;**
  - (c) **Total revenue and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to owners of the controlling entity and to minority interest; and**
  - (d) **For each component of net assets/equity separately disclosed, the effects of changes in accounting policies and corrections of errors recognized in accordance with IPSAS 3.**
119. **An entity shall also present, either on the face of the statement of changes in net assets/equity or in the notes:**
- (a) **The amounts of transactions with owners acting in their capacity as owners, showing separately distributions to owners;**
  - (b) **The balance of accumulated surpluses or deficits at the beginning of the period and at the reporting date, and the changes during the period; and**
  - (c) **To the extent that components of net assets/equity are separately disclosed, a reconciliation between the carrying amount of each component of net assets/equity at the beginning and the end of the period, separately disclosing each change.**
120. Changes in an entity’s net assets/equity between two reporting dates reflect the increase or decrease in its net assets during the period.
121. The overall change in net assets/equity during a period represents the total amount of surplus or deficit for the period, other revenues and expenses recognized directly as changes in net assets/equity, together with any contributions by, and distributions to, owners in their capacity as owners.

122. Contributions by, and distributions to, owners include transfers between two entities within an economic entity (for example, a transfer from a government, acting in its capacity as owner, to a government department). Contributions by owners, in their capacity as owners, to controlled entities are recognized as a direct adjustment to net assets/equity only where they explicitly give rise to residual interests in the entity in the form of rights to net assets/equity.
123. This Standard requires all items of revenue and expense recognized in a period to be included in surplus or deficit unless another IPSAS requires otherwise. Other Standards require some items (such as revaluation increases and decreases, particular foreign exchange differences) to be recognized directly as changes in net assets/equity. Because it is important to consider all items of revenue and expense in assessing changes in an entity's financial position between two reporting dates, this Standard requires the presentation of a statement of changes in net assets/equity that highlights an entity's total revenue and expenses, including those that are recognized directly in net assets/equity.
124. IPSAS 3 requires retrospective adjustments to effect changes in accounting policies, to the extent practicable, except when the transitional provisions in another IPSAS require otherwise. IPSAS 3 also requires that restatements to correct errors are made retrospectively, to the extent practicable. Retrospective adjustments and retrospective restatements are made to the balance of accumulated surpluses or deficits, except when an IPSAS requires retrospective adjustment of another component of net assets/equity. Paragraph 118(d) requires disclosure in the statement of changes in net assets/equity of the total adjustment to each component of net assets/equity separately disclosed resulting, separately, from changes in accounting policies and from corrections of errors. These adjustments are disclosed for each prior period and the beginning of the period.
125. The requirements in paragraphs 118 and 119 may be met by using a columnar format that reconciles the opening and closing balances of each element within net assets/equity. An alternative is to present only the items set out in paragraph 118 in the statement of changes in net assets/equity. Under this approach, the items described in paragraph 119 are shown in the notes.

### **Cash Flow Statement**

126. Cash flow information provides users of financial statements with a basis to assess the ability of the entity to generate cash and cash equivalents and the needs of the entity to utilize those cash flows. IPSAS 2 sets out requirements for the presentation of the cash flow statement and related disclosures.

**Notes***Structure*

127. **The notes shall:**
- (a) **Present information about the basis of preparation of the financial statements and the specific accounting policies used in accordance with paragraphs 132–139;**
  - (b) **Disclose the information required by IPSASs that is not presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement; and**
  - (c) **Provide additional information that is not presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement, but that is relevant to an understanding of any of them.**
128. **Notes shall, as far as practicable, be presented in a systematic manner. Each item on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement shall be cross-referenced to any related information in the notes.**
129. Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with financial statements of other entities:
- (a) A statement of compliance with IPSASs (see paragraph 28);
  - (b) A summary of significant accounting policies applied (see paragraph 132);
  - (c) Supporting information for items presented on the face of the statement of financial position, statement of financial performance, statement of changes in net assets/equity or cash flow statement, in the order in which each statement and each line item is presented; and
  - (d) Other disclosures, including:
    - (i) Contingent liabilities (see IPSAS 19), and unrecognized contractual commitments; and
    - (ii) Non-financial disclosures, e.g., the entity's financial risk management objectives and policies (see IPSAS 15).
130. In some circumstances, it may be necessary or desirable to vary the ordering of specific items within the notes. For example, information on changes in fair value recognized in surplus or deficit may be combined with information on maturities of financial instruments, although the former disclosures relate to the

statement of financial performance and the latter relate to the statement of financial position. Nevertheless, a systematic structure for the notes is retained as far as practicable.

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

*Disclosure of Accounting Policies*

132. **An entity shall disclose in the summary of significant accounting policies:**
- (a) **The measurement basis (or bases) used in preparing the financial statements;**
  - (b) **The extent to which the entity has applied any transitional provisions in any IPSAS; and**
  - (c) **The other accounting policies used that are relevant to an understanding of the financial statements.**
133. It is important for users to be informed of the measurement basis or bases used in the financial statements (for example, historical cost, current cost, net realizable value, fair value, recoverable amount or recoverable service amount) because the basis on which the financial statements are prepared significantly affects their analysis. When more than one measurement basis is used in the financial statements, for example when particular classes of assets are revalued, it is sufficient to provide an indication of the categories of assets and liabilities to which each measurement basis is applied.
134. In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions, other events and conditions are reflected in the reported financial performance and financial position. Disclosure of particular accounting policies is especially useful to users when those policies are selected from alternatives allowed in IPSASs. An example is disclosure of whether a venturer recognizes its interest in a jointly controlled entity using proportionate consolidation or the equity method (see IPSAS 8, “Interests in Joint Ventures”). Some Standards specifically require disclosure of particular accounting policies, including choices made by management between different policies they allow. For example, IPSAS 17 requires disclosure of the measurement bases used for classes of property, plant and equipment. IPSAS 5, “Borrowing Costs” requires disclosure of whether borrowing costs are recognized immediately as an expense or capitalized as part of the cost of qualifying assets.
135. Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. For example, public sector entities would be expected to disclose an accounting policy for recognition of taxes, donations and other forms of non-exchange

revenue. When an entity has significant foreign operations or transactions in foreign currencies, disclosure of accounting policies for the recognition of foreign exchange gains and losses would be expected. When entity combinations have occurred, the policies used for measuring goodwill and minority interest are disclosed.

136. An accounting policy may be significant because of the nature of the entity's operation even if amounts for current and prior periods are not material. It is also appropriate to disclose each significant accounting policy that is not specifically required by IPSASs, but is selected and applied in accordance with IPSAS 3.
137. **An entity shall disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations (see paragraph 140), management has made in the process of applying the entity's accounting policies that have the most significant effect on the amounts recognized in the financial statements.**
138. In the process of applying the entity's accounting policies, management makes various judgments, apart from those involving estimations, that can significantly affect the amounts recognized in the financial statements. For example, management makes judgments in determining:
- (a) Whether assets are investments properties;
  - (b) Whether agreements for the provision of goods and/or services that involve the use of dedicated assets are leases;
  - (c) Whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; and
  - (d) Whether the substance of the relationship between the reporting entity and other entities indicates that these other entities are controlled by the reporting entity.
139. Some of the disclosures made in accordance with paragraph 137 are required by other Standards. For example, IPSAS 6 requires an entity to disclose the reasons why the entity's ownership interest does not constitute control, in respect of an investee that is not a controlled entity even though more than half of its voting or potential voting power is owned directly or indirectly through controlled entities. IPSAS 16, "Investment Property" requires disclosure of the criteria developed by the entity to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of business, when classification of the property is difficult.

*Key Sources of Estimation Uncertainty*

140. **An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation**

**uncertainty at the reporting date, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:**

- (a) **Their nature; and**
  - (b) **Their carrying amount as at the reporting date.**
141. Determining the carrying amounts of some assets and liabilities requires estimation of the effects of uncertain future events on those assets and liabilities at the reporting date. For example, in the absence of recently observed market prices used to measure the following assets and liabilities, future-oriented estimates are necessary to measure the recoverable amount of certain classes of property, plant and equipment, the effect of technological obsolescence on inventories, provisions subject to the future outcome of litigation in progress. These estimates involve assumptions about such items as the risk adjustment to cash flows or discount rates used and future changes in prices affecting other costs.
142. The key assumptions and other key sources of estimation uncertainty disclosed in accordance with paragraph 140 relate to the estimates that require management's most difficult, subjective or complex judgments. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increases, those judgments become more subjective and complex, and the potential for a consequential material adjustment to the carrying amounts of assets and liabilities normally increases accordingly.
143. The disclosures in paragraph 140 are not required for assets and liabilities with a significant risk that their carrying amounts might change materially within the next financial year if, at the reporting date, they are measured at fair value based on recently observed market prices (their fair values might change materially within the next financial year but these changes would not arise from assumptions or other sources of estimation uncertainty at the reporting date).
144. The disclosures in paragraph 140 are presented in a manner that helps users of financial statements to understand the judgments management makes about the future and about other key sources of estimation uncertainty. The nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures made are:
- (a) The nature of the assumption or other estimation uncertainty;
  - (b) The sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;

- (c) The expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in respect of the carrying amounts of the assets and liabilities affected; and
  - (d) An explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.
145. It is not necessary to disclose budget information or forecasts in making the disclosures in paragraph 140.
146. When it is impracticable to disclose the extent of the possible effects of a key assumption or another key source of estimation uncertainty at the reporting date, the entity discloses that it is reasonably possible, based on existing knowledge, that outcomes within the next financial year that are different from assumptions could require a material adjustment to the carrying amount of the asset or liability affected. In all cases, the entity discloses the nature and carrying amount of the specific asset or liability (or class of assets or liabilities) affected by the assumption.
147. The disclosures in paragraph 137 of particular judgments management made in the process of applying the entity's accounting policies do not relate to the disclosures of key sources of estimation uncertainty in paragraph 140.
148. The disclosure of some of the key assumptions that would otherwise be required in accordance with paragraph 140 is required by other Standards. For example, IPSAS 19 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. IPSAS 15 requires disclosure of significant assumptions applied in estimating fair values of financial assets and financial liabilities that are carried at fair value. IPSAS 17 requires disclosure of significant assumptions applied in estimating fair values of revalued items of property, plant and equipment.

*Other Disclosures*

149. **An entity shall disclose in the notes:**
- (a) **The amount of dividends, or similar distributions, proposed or declared before the financial statements were authorized for issue but not recognized as a distribution to owners during the period, and the related amount per share; and**
  - (b) **The amount of any cumulative preference dividends, or similar distributions, not recognized.**
150. **An entity shall disclose the following, if not disclosed elsewhere in information published with the financial statements:**
- (a) The domicile and legal form of the entity, and the jurisdiction within which it operates;

- (b) **A description of the nature of the entity's operations and principal activities;**
- (c) **A reference to the relevant legislation governing the entity's operations; and**
- (d) **The name of the controlling entity and the ultimate controlling entity of the economic entity (where applicable).**

### **Transitional Provisions**

151. **All provisions of this Standard shall be applied from the date of first adoption of this Standard, except in relation to items that have not been recognized as a result of transitional provisions under another IPSAS. The disclosure provisions of this Standard would not be required to apply to such items until the transitional provision in the other IPSAS expires. Comparative information is not required in respect of the financial statements to which accrual accounting is first adopted in accordance with IPSASs.**
152. Notwithstanding the existence of transitional provisions under another IPSAS, entities that are in the process of adopting the accrual basis of accounting for financial reporting purposes are encouraged to comply in full with the provisions of that other Standard as soon as possible.

### **Effective Date**

153. **An entity shall apply this IPSAS for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
154. When an entity adopts the accrual basis of accounting, as defined by IPSASs, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

### **Withdrawal of IPSAS 1 (2000)**

155. This Standard supersedes IPSAS 1, "Presentation of Financial Statements" issued in 2000.

**Appendix A****Amendments to Other IPSASs**

*The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after January 1, 2008. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.*

- A1 In IPSASs applicable at January 1, 2008:
- (a) References to net surplus or deficit are amended to surplus or deficit; and
  - (b) References to notes to the financial statements are amended to notes.

## Appendix B

### Qualitative Characteristics of Financial Reporting

*This appendix is an integral part of the Standard.*

Paragraph 29 of this Standard requires an entity to present information, including accounting policies, in a manner that meets a number of qualitative characteristics. This guidance summarizes the qualitative characteristics of financial reporting.

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

#### Understandability

Information is understandable when users might reasonably be expected to comprehend its meaning. For this purpose, users are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, and to be willing to study the information.

Information about complex matters should not be excluded from the financial statements merely on the grounds that it may be too difficult for certain users to understand.

#### Relevance

Information is relevant to users if it can be used to assist in evaluating past, present or future events or in confirming, or correcting, past evaluations. In order to be relevant, information must also be timely.

#### *Materiality*

The relevance of information is affected by its nature and materiality.

Information is material if its omission or misstatement could influence the decisions of users or assessments made on the basis of the financial statements. Materiality depends on the nature or size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

#### Reliability

Reliable information is free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent.

*Faithful Representation*

For information to represent faithfully transactions and other events, it should be presented in accordance with the substance of the transactions and other events, and not merely their legal form.

*Substance Over Form*

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with their legal form.

*Neutrality*

Information is neutral if it is free from bias. Financial statements are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

*Prudence*

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated and liabilities or expenses are not understated.

However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or revenue, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

*Completeness*

The information in financial statements should be complete within the bounds of materiality and cost.

**Comparability**

Information in financial statements is comparable when users are able to identify similarities and differences between that information and information in other reports.

Comparability applies to the:

- Comparison of financial statements of different entities; and
- Comparison of the financial statements of the same entity over periods of time.

An important implication of the characteristic of comparability is that users need to be informed of the policies employed in the preparation of financial statements, changes to those policies and the effects of those changes.

Because users wish to compare the performance of an entity over time, it is important that financial statements show corresponding information for preceding periods.

### **Constraints on Relevant and Reliable Information**

#### *Timeliness*

If there is an undue delay in the reporting of information it may lose its relevance. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the decision-making needs of users.

#### *Balance between Benefit and Cost*

The balance between benefit and cost is a pervasive constraint. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a matter of judgment. Furthermore, the costs do not always fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information was prepared. For these reasons, it is difficult to apply a benefit-cost test in any particular case. Nevertheless, standard-setters, as well as those responsible for the preparation of financial statements and users of financial statements, should be aware of this constraint.

#### *Balance between Qualitative Characteristics*

In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

## Implementation Guidance – Illustrative Financial Statement Structure

*This guidance accompanies, but is not part of, IPSAS 1.*

- IG1. The Standard sets out the components of financial statements and minimum requirements for disclosure on the face of the statement of financial position and the statement of financial performance as well as for the presentation of changes in net assets/equity. It also describes further items that may be presented either on the face of the relevant financial statement or in the notes. This guidance provides simple examples of the ways in which the requirements of the Standard for the presentation of the statement of financial position, statement of financial performance and changes in net assets/equity might be met. The order of presentation and the descriptions used for line items should be changed when necessary in order to achieve a fair presentation in each entity's particular circumstances. For example, line items of a public sector entity such as a defense department are likely to be significantly different from those for a central bank.
- IG2. The illustrative statement of financial position shows one way in which a statement of financial position distinguishing between current and non-current items may be presented. Other formats may be equally appropriate, provided the distinction is clear.
- IG3. The financial statements have been prepared for a national government and the statement of financial performance (by function) illustrates the functions of government classifications used in the Government Finance Statistics. These functional classifications are unlikely to apply to all public sector entities. Refer to this Standard for an example of more generic functional classifications for other public sector entities.
- IG4. The examples are not intended to illustrate all aspects of IPSASs. Nor do they comprise a complete set of financial statements, which would also include a cash flow statement, a summary of significant accounting policies and other explanatory notes.

## **PUBLIC SECTOR ENTITY – STATEMENT OF ACCOUNTING POLICIES (EXTRACT)**

### **Reporting Entity**

These financial statements are for a public sector entity (national government of Country A). The financial statements encompass the reporting entity as specified in the relevant legislation (Public Finance Act 20XX). This comprises:

- Central government ministries; and
- Government Business Enterprises.

### **Basis of Preparation**

The financial statements comply with International Public Sector Accounting Standards for the accrual basis of accounting. The measurement base applied is historical cost adjusted for revaluations of assets.

The financial statements have been prepared on a going concern basis and the accounting policies have been applied consistently throughout the period.

## PUBLIC SECTOR ENTITY – STATEMENT OF FINANCIAL POSITION

AS AT DECEMBER 31, 20X2  
(in thousands of currency units)

	20X2	20X1
<b>ASSETS</b>		
<b>Current assets</b>		
Cash and cash equivalents	X	X
Receivables	X	X
Inventories	X	X
Prepayments	X	X
Other current assets	X	X
	<u>X</u>	<u>X</u>
<b>Non-current assets</b>		
Receivables	X	X
Investments in associates	X	X
Other financial assets	X	X
Infrastructure, plant and equipment	X	X
Land and buildings	X	X
Intangible assets	X	X
Other non-financial assets	X	X
	<u>X</u>	<u>X</u>
<b>Total assets</b>	<u>X</u>	<u>X</u>
<b>LIABILITIES</b>		
<b>Current liabilities</b>		
Payables	X	X
Short-term borrowings	X	X
Current portion of long-term borrowings	X	X
Short-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	<u>X</u>	<u>X</u>
<b>Non-current liabilities</b>		
Payables	X	X
Long-term borrowings	X	X
Long-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	<u>X</u>	<u>X</u>
<b>Total liabilities</b>	<u>X</u>	<u>X</u>
<b>Net assets</b>	<u>X</u>	<u>X</u>
<b>NET ASSETS/EQUITY</b>		
Capital contributed by		
Other government entities	X	X
Reserves	X	X
Accumulated surpluses/(deficits)	X	X
Minority interest	X	X
<b>Total net assets/equity</b>	<u>X</u>	<u>X</u>

**PUBLIC SECTOR ENTITY – STATEMENT OF FINANCIAL PERFORMANCE FOR THE YEAR ENDED DECEMBER 31, 20X2**

*(Illustrating the Classification of Expenses by Function)*

(in thousands of currency units)

	20X2	20X1
<b>Revenue</b>		
Taxes	X	X
Fees, fines, penalties and licenses	X	X
Revenue from exchange transactions	X	X
Transfers from other government entities	X	X
Other revenue	X	X
<b>Total revenue</b>	<u>X</u>	<u>X</u>
<b>Expenses</b>		
General public services	(X)	(X)
Defense	(X)	(X)
Public order and safety	(X)	(X)
Education	(X)	(X)
Health	(X)	(X)
Social protection	(X)	(X)
Housing and community amenities	(X)	(X)
Recreational, cultural and religion	(X)	(X)
Economic affairs	(X)	(X)
Environmental protection	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
<b>Total expenses</b>	<u>(X)</u>	<u>(X)</u>
Share of surplus of associates*	X	X
<b>Surplus/(deficit) for the period</b>	<u>X</u>	<u>X</u>
Attributable to:		
Owners of the controlling entity	X	X
Minority interests	X	X
	<u>X</u>	<u>X</u>

\* This means the share of associates' surplus attributable to owners of the associates, i.e., it is after tax and minority interests in the associates.

**PUBLIC SECTOR ENTITY – STATEMENT OF FINANCIAL PERFORMANCE FOR THE YEAR ENDED DECEMBER 31, 20X2**

*(Illustrating the Classification of Expenses by Nature)*

(in thousands of currency units)

	20X2	20X1
<b>Revenue</b>		
Taxes	X	X
Fees, fines, penalties and licenses	X	X
Revenue from exchange transactions	X	X
Transfers from other government entities	X	X
Other revenue	X	X
<b>Total Revenue</b>	<u>X</u>	<u>X</u>
<b>Expenses</b>		
Wages, salaries and employee benefits	(X)	(X)
Grants and other transfer payments	(X)	(X)
Supplies and consumables used	(X)	(X)
Depreciation and amortization expense	(X)	(X)
Impairment of property, plant and equipment*	(X)	(X)
Other expenses	(X)	(X)
Finance costs	(X)	(X)
<b>Total Expenses</b>	<u>(X)</u>	<u>(X)</u>
Share of surplus of associates	<u>X</u>	<u>X</u>
<b>Surplus/(deficit) for the period</b>	<u>X</u>	<u>X</u>
Attributable to:		
Owners of the controlling entity	X	X
Minority interest	X	X
	<u>X</u>	<u>X</u>

\* In a statement of financial performance in which expenses are classified by nature, an impairment of property, plant and equipment is shown as a separate line item. By contrast, if expenses are classified by function, the impairment is included in the function(s) to which it relates.

PRESENTATION OF FINANCIAL STATEMENTS

**PUBLIC SECTOR ENTITY – STATEMENT OF CHANGES IN NET ASSETS/EQUITY FOR THE YEAR ENDED DECEMBER 31, 20X1**

(in thousands of currency units)

	Attributable to owners of the controlling entity					Minority interest	Total net assets/equity
	Contributed Capital	Other Reserves <sup>1</sup>	Translation Reserve	Accumulated Surpluses/ (Deficits)	Total		
Balance at December 31, 20X0	X	X	(X)	X	X	X	X
Changes in accounting policy				(X)	(X)	(X)	(X)
Restated balance	X	X	(X)	X	X	X	X
<b>Changes in net assets/equity for 20X1</b>							
Gain on property revaluation		X			X	X	X
Loss on revaluation of investments		(X)			(X)	(X)	(X)
Exchange differences on translating foreign operations			(X)		(X)	(X)	(X)
Net revenue recognized directly in net assets/equity		X	(X)		X	X	X
Surplus for the period				X	X	X	X
<b>Total recognized revenue and expense for the period</b>		X	(X)	X	X	X	X
<b>Balance at December 31, 20X1 carried forward</b>	X	X	(X)	X	X	X	X

<sup>1</sup> Other reserves are analyzed into their components, if material.

PRESENTATION OF FINANCIAL STATEMENTS

**PUBLIC SECTOR ENTITY – STATEMENT OF CHANGES IN NET ASSETS/EQUITY FOR THE YEAR ENDED DECEMBER 31, 20X1**

(in thousands of currency units)

	Attributable to owners of the controlling entity					Minority interest	Total net assets/equity
	Contributed Capital	Other Reserves <sup>1</sup>	Translation Reserve	Accumulated Surpluses/ (Deficits)	Total		
<b>Balance at December 31, 20X1 brought forward</b>	X	X	(X)	X	X	X	X
<b>Changes in net assets/equity for 20X2</b>							<i>continued</i>
Loss on property revaluation		(X)			(X)	(X)	(X)
Gain on revaluation of investments		X			X	X	X
Exchange differences on translating foreign operations			(X)		(X)	(X)	(X)
Net revenue recognized directly in net assets/equity		(X)	(X)		(X)	(X)	(X)
Deficit for the period				(X)	(X)	(X)	(X)
<b>Total recognized revenue and expense for the period</b>		(X)	(X)	(X)	(X)	(X)	(X)
<b>Balance at December 31, 20X2</b>	X	X	(X)	X	X	X	X

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, IPSAS 1. This Basis for Conclusions only notes the IPSASB's reasons for departing from the provisions of the related International Accounting Standard.*

### Background

- BC1. The IPSASB's IFRSs convergence program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the Comparison with IFRS included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 IASs<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements Project were to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements. The final IASs were issued in December 2003.
- BC4. IPSAS 1, issued in January 2000 was based on IAS 1 (revised 1997), which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the PSC<sup>2</sup>, actioned an IPSAS improvements project to converge where appropriate IPSASs with the improved IASs issued in December 2003. In developing the IPSAS improvements project, the IPSASB adopted a policy of making only those changes to IPSASs related to changes made to the equivalent IAS as part of the IASB's General Improvements Project, subsequent changes to IASs have not been included. Where the original IPSAS varied from the provisions of the related IAS, to better cater for the financial reporting requirements of the public sector, the IPSASB has retained those variations and identified them in the Comparison with IAS 1.

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<sup>1</sup> IASs were issued by the IASB's predecessor, the IASC. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

- BC5. The IPSASB reviewed the improved IAS 1 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The IASB's Basis for Conclusions is not reproduced here. Subscribers to the IASB's Comprehensive Subscription Service can view the Basis for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)). In some limited cases, the IPSASB disagreed with the amendments made to the IAS. Consequently, the IPSAS departs from its equivalent IAS in this respect. This Basis for Conclusions explains the public sector specific reasons for any departure.
- BC6. IAS 1 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 1 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

#### *Income*

- BC7. IAS 1 uses the term income, which is not used in IPSAS 1. IPSAS 1 uses revenue, which corresponds to income in the IASs/IFRSs. The term income is broader than revenue, encompassing gains in addition to revenue. The IPSASs do not include a definition of income and introducing such a definition was not part of the improvements project and was not included in the ED 26.

#### *Extraordinary Items*

- BC8. IAS 1 prohibits an entity from presenting any item of income or expense as extraordinary items, either on the face of the income statement or in the notes. The IASB concluded that items treated as extraordinary result from the normal business risks faced by an entity and do not warrant presentation in a separate component of the income statement. The nature or function of a transaction or other event, rather than its frequency, should determine its presentation within the income statement.
- BC9. The definition of extraordinary items in IPSAS 1 (2000) differed from the definition included in the previous (1993) version of IAS 8, "Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies."<sup>3</sup> This difference reflected the public sector view of what constituted an extraordinary item for public sector entities.
- BC10. The Standard does not explicitly preclude the presentation of items of revenue and expense as extraordinary items either on the face of the statement of

<sup>3</sup> IPSAS 1 (2000) defined extraordinary items as "revenue or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the entity, are not expected to recur frequently or regularly and are outside the control or influence of the entity." IAS 8 defined "extraordinary items" as "income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly."

financial performance or in the notes. IAS 1 prohibits any items of income and expense to be presented as extraordinary items either on the face of the income statement or in the notes. The IPSASB is of the view that IPSASs should not prohibit entities from disclosing extraordinary items in the notes to, or on the face of, the statement of financial performance. This is because they believe that the disclosure of information about extraordinary items may be consistent with the objectives and qualitative characteristics of financial reporting. However, other members are of the view that there is not a public sector specific reason to depart from the requirements of IAS 1 in respect of this matter. They also noted that IPSAS 1 does not preclude the separate presentation of items that are distinct from the ordinary activities of a government, either on the face of the financial statements or in the notes, as long as these items are material. They are not convinced that there is a public sector specific reason to depart from the IASB's prohibition on presenting "extraordinary items" in the financial statements.

### Comparison with IAS 1

IPSAS 1 is drawn primarily from IAS 1 (2003). At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 5, “Non-current Assets Held for Sale and Discontinued Operations,” to public sector entities; therefore IPSAS 1 does not reflect amendments made to IAS 1 consequent upon the issuing of IFRS 5. The main differences between IPSAS 1 and IAS 1 are as follows:

- Commentary additional to that in IAS 1 has been included in IPSAS 1 to clarify the applicability of the Standards to accounting by public sector entities e.g., discussion on the application of the going concern concept has been expanded.
- IAS 1 allows the presentation of either a statement showing all changes in net assets/equity, or a statement showing changes in net assets/equity other than those arising from capital transactions with owners and distributions to owners in their capacity as owners. IPSAS 1 requires the presentation of a statement showing all changes in net assets/equity.
- IPSAS 1 uses different terminology, in certain instances, from IAS 1. The most significant examples are the use of the terms statement of financial performance, statement of financial position and net assets/equity in IPSAS 1. The equivalent terms in IAS 1 are income statement, balance sheet and equity.
- IPSAS 1 does not use the term income, which in IAS 1 has a broader meaning than the term revenue.
- IAS 1 defines “International Financial Reporting Standards (IFRSs)” to include IFRSs, IASs and SIC/IFRIC Interpretations. IPSAS 1 does not define “International Public Sector Accounting Standards.”
- IPSAS 1 contains a different set of definitions of technical terms from IAS 1 (paragraph 7).
- IPSAS 1 contains commentary on the responsibility for the preparation of financial statements. IAS 1 does not include the same commentary (paragraphs 19–20).
- IPSAS 1 uses the phrase the objective of financial statements set out in this IPSAS to replace the equivalent phrase the objective of financial statement set out in the Framework in IAS 1. This is because an equivalent Framework in IPSASs does not exist.
- IPSAS 1 contains commentary on timeliness of financial statements because of the lack of an equivalent Framework in IPSASs (paragraph 69).
- IPSAS 1 does not explicitly preclude the presentation of items of revenue and expense as extraordinary items either on the face of the statement of financial performance or in the notes. IAS 1 prohibits any items of income and expense to be presented as extraordinary items either on the face of the income statement or in the notes.

- IPSAS 1 contains a transitional provision allowing the non-disclosure of items which have been excluded from the financial statements due to the application of a transitional provision in another IPSAS (paragraph 151).
- IPSAS 1 contains an authoritative summary of qualitative characteristics (based on the IASB framework) in Appendix B.

## IPSAS 2—CASH FLOW STATEMENTS

### Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 7, “Cash Flow Statements” published by the International Accounting Standards Board (IASB). Extracts from IAS 7 are reproduced in this publication of the International Public Sector Account Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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## IPSAS 2—CASH FLOW STATEMENTS

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Appendix: Cash Flow Statement (For an Entity Other Than  
a Financial Institution)

Comparison with IAS 7

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## Objective

The cash flow statement identifies the sources of cash inflows, the items on which cash was expended during the reporting period, and the cash balance as at the reporting date. Information about the cash flows of an entity is useful in providing users of financial statements with information for both accountability and decision making purposes. Cash flow information allows users to ascertain how a public sector entity raised the cash it required to fund its activities and the manner in which that cash was used. In making and evaluating decisions about the allocation of resources, such as the sustainability of the entity's activities, users require an understanding of the timing and certainty of cash flows. The objective of this Standard is to require the provision of information about the historical changes in cash and cash equivalents of an entity by means of a cash flow statement which classifies cash flows during the period from operating, investing and financing activities.

## Scope

1. **An entity which prepares and presents financial statements under the accrual basis of accounting should prepare a cash flow statement in accordance with the requirements of this Standard and should present it as an integral part of its financial statements for each period for which financial statements are presented.**
2. Information about cash flows may be useful to users of an entity's financial statements in assessing the entity's cash flows, assessing the entity's compliance with legislation and regulations (including authorized budgets where appropriate) and for making decisions about whether to provide resources to, or enter into transactions with an entity. They are generally interested in how the entity generates and uses cash and cash equivalents. This is the case regardless of the nature of the entity's activities and irrespective of whether cash can be viewed as the product of the entity, as may be the case with a public financial institution. Entities need cash for essentially the same reasons, however different their principal revenue producing activities might be. They need cash to pay for the goods and services they consume, to meet ongoing debt servicing costs, and, in some cases, to reduce levels of debt. Accordingly, this Standard requires all entities to present a cash flow statement.
3. **This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).**
4. The "Preface to International Public Sector Accounting Standards" issued by the IPSASB explains that GBEs apply IFRSs which are issued by the IASB. GBEs are defined in IPSAS 1, "Presentation of Financial Statements."

## Benefits of Cash Flow Information

5. Information about the cash flows of an entity is useful in assisting users to predict the future cash requirements of the entity, its ability to generate cash flows in the future and to fund changes in the scope and nature of its activities. A cash flow statement also provides a means by which an entity can discharge its accountability for cash inflows and cash outflows during the reporting period.
6. A cash flow statement, when used in conjunction with other financial statements, provides information that enables users to evaluate the changes in net assets/equity of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. It also enhances the comparability of the reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and other events.
7. Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows.

## Definitions

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

**Accrual basis** means a basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under the accrual basis are assets, liabilities, net assets/equity, revenue and expenses.

**Assets** are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

**Cash** comprises cash on hand and demand deposits.

**Cash equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.

**Cash flows** are inflows and outflows of cash and cash equivalents.

**Contributions from owners** means future economic benefits or service potential that has been contributed to the entity by parties external to

the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:

- (a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) Can be sold, exchanged, transferred or redeemed.

**Control** is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

**Distributions to owners** means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

**Economic entity** means a group of entities comprising a controlling entity and one or more controlled entities.

**Expenses** are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.

**Financing activities** are activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.

**Government Business Enterprise (GBEs)** means an entity that has all the following characteristics:

- (a) Is an entity with the power to contract in its own name;
- (b) Has been assigned the financial and operational authority to carry on a business;
- (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
- (e) Is controlled by a public sector entity.

**Investing activities** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

**Liabilities** are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

**Net assets/equity** is the residual interest in the assets of the entity after deducting all its liabilities.

**Operating activities** are the activities of the entity that are not investing or financing activities.

**Reporting date** means the date of the last day of the reporting period to which the financial statements relate.

**Revenue** is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

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

### **Cash and Cash Equivalents**

9. Cash equivalents are held for the purpose of meeting short term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents.
10. Bank borrowings are generally considered to be financing activities. However, in some countries, bank overdrafts which are repayable on demand form an integral part of an entity's cash management. In these circumstances, bank overdrafts are included as a component of cash and cash equivalents. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.
11. Cash flows exclude movements between items that constitute cash or cash equivalents because these components are part of the cash management of an entity rather than part of its operating, investing and financing activities. Cash management includes the investment of excess cash in cash equivalents.

### **Economic Entity**

12. The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.
13. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity and group.

14. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

#### **Future Economic Benefits or Service Potential**

15. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity's objectives but which do not directly generate net cash inflows are often described as embodying service potential. Assets that are used to generate net cash inflows are often described as embodying future economic benefits. To encompass all the purposes to which assets may be put, this Standard uses the term future economic benefits or service potential to describe the essential characteristic of assets.

#### **Government Business Enterprises**

16. GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. IPSAS 6, "Consolidated and Separate Financial Statements" provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.

#### **Net Assets/Equity**

17. Net assets/equity is the term used in this Standard to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

#### **Presentation of a Cash Flow Statement**

18. **The cash flow statement should report cash flows during the period classified by operating, investing and financing activities.**
19. An entity presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its activities. Classification by activity provides information that allows users to assess the impact of those activities on the financial position of the entity and the

amount of its cash and cash equivalents. This information may also be used to evaluate the relationships among those activities.

20. A single transaction may include cash flows that are classified differently. For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element is classified as a financing activity.

### Operating Activities

21. The amount of net cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity are funded:
- (a) By way of taxes (directly and indirectly); or
  - (b) From the recipients of goods and services provided by the entity.

The amount of the net cash flows also assists in showing the ability of the entity to maintain its operating capability, repay obligations, pay a dividend or similar distribution to its owner and make new investments without recourse to external sources of financing. The consolidated whole-of-government operating cash flows provide an indication of the extent to which a government has financed its current activities through taxation and charges. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

22. Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. Examples of cash flows from operating activities are:
- (a) Cash receipts from taxes, levies and fines;
  - (b) Cash receipts from charges for goods and services provided by the entity;
  - (c) Cash receipts from grants or transfers and other appropriations or other budget authority made by central government or other public sector entities;
  - (d) Cash receipts from royalties, fees, commissions and other revenue;
  - (e) Cash payments to other public sector entities to finance their operations (not including loans);
  - (f) Cash payments to suppliers for goods and services;
  - (g) Cash payments to and on behalf of employees;
  - (h) Cash receipts and cash payments of an insurance entity for premiums and claims, annuities and other policy benefits;

- (i) Cash payments of local property taxes or income taxes (where appropriate) in relation to operating activities;
- (j) Cash receipts and payments from contracts held for dealing or trading purposes;
- (k) Cash receipts or payments from discontinuing operations; and
- (l) Cash receipts or payments in relation to litigation settlements.

Some transactions, such as the sale of an item of plant, may give rise to a gain or loss which is included in the determination of net surplus or deficit. However, the cash flows relating to such transactions are cash flows from investing activities.

- 23. An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by public financial institutions are usually classified as operating activities since they relate to the main cash-generating activity of that entity.
- 24. In some jurisdictions, governments or other public sector entities will appropriate or authorize funds to entities to finance the operations of an entity and no clear distinction is made for the disposition of those funds between current activities, capital works and contributed capital. Where an entity is unable to separately identify appropriations or budgetary authorizations into current activities, capital works and contributed capital, the appropriation or budget authorization should be classified as cash flows from operations and this fact should be disclosed in the notes to the financial statements.

### **Investing Activities**

- 25. The separate disclosure of cash flows arising from investing activities is important because the cash flows represent the extent to which cash outflows have been made for resources which are intended to contribute to the entity's future service delivery. Examples of cash flows arising from investing activities are:
  - (a) Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalized development costs and self-constructed property, plant and equipment;
  - (b) Cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

- (c) Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
- (d) Cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
- (e) Cash advances and loans made to other parties (other than advances and loans made by a public financial institution);
- (f) Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a public financial institution);
- (g) Cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and
- (h) Cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

When a contract is accounted for as a hedge of an identifiable position, the cash flows of the contract are classified in the same manner as the cash flows of the position being hedged.

#### **Financing Activities**

26. The separate disclosure of cash flows arising from financing activities is important because it is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:
- (a) Cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short or long-term borrowings;
  - (b) Cash repayments of amounts borrowed; and
  - (c) Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

#### **Reporting Cash Flows from Operating Activities**

27. **An entity should report cash flows from operating activities using either:**

- (a) **The direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or**
  - (b) **The indirect method, whereby net surplus or deficit is adjusted for the effects of transactions of a noncash nature, any deferrals or accruals of past or future operating cash receipts or payments, and items of revenue or expense associated with investing or financing cash flows.**
28. Entities are encouraged to report cash flows from operating activities using the direct method. The direct method provides information which may be useful in estimating future cash flows and which is not available under the indirect method. Under the direct method, information about major classes of gross cash receipts and gross cash payments may be obtained either:
- (a) From the accounting records of the entity; or
  - (b) By adjusting operating revenues, operating expenses (interest and similar revenue, and interest expense and similar charges for a public financial institution) and other items in the statement of financial performance for:
    - (i) Changes during the period in inventories and operating receivables and payables;
    - (ii) Other noncash items; and
    - (iii) Other items for which the cash effects are investing or financing cash flows.
29. Entities reporting cash flows from operating activities using the direct method are also encouraged to provide a reconciliation of the surplus/deficit from ordinary activities with the net cash flow from operating activities. This reconciliation may be provided as part of the cash flow statement or in the notes to the financial statements.
30. Under the indirect method, the net cash flow from operating activities is determined by adjusting net surplus or deficit from ordinary activities for the effects of:
- (a) Changes during the period in inventories and operating receivables and payables;
  - (b) Noncash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, undistributed surpluses of associates, and minority interests;
  - (c) All other items for which the cash effects are investing or financing cash flows; and

- (d) The impact of any extraordinary items which are classified as operating cash flows.

### **Reporting Cash Flows from Investing and Financing Activities**

- 31. **An entity should report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities, except to the extent that cash flows described in paragraphs 32 and 35 are reported on a net basis.**

### **Reporting Cash Flows on a Net Basis**

- 32. **Cash flows arising from the following operating, investing or financing activities may be reported on a net basis:**
  - (a) **Cash receipts collected and payments made on behalf of customers, taxpayers or beneficiaries when the cash flows reflect the activities of the other party rather than those of the entity; and**
  - (b) **Cash receipts and payments for items in which the turnover is quick, the amounts are large, and the maturities are short.**
- 33. Paragraph 32(a) refers only to transactions where the resulting cash balances are controlled by the reporting entity. Examples of such cash receipts and payments include:
  - (a) The collection of taxes by one level of government for another level of government, not including taxes collected by a government for its own use as part of a tax sharing arrangement;
  - (b) The acceptance and repayment of demand deposits of a public financial institution;
  - (c) Funds held for customers by an investment or trust entity; and
  - (d) Rents collected on behalf of, and paid over to, the owners of properties.
- 34. Examples of cash receipts and payments referred to in paragraph 32(b) are advances made for, and the repayment of:
  - (a) The purchase and sale of investments; and
  - (b) Other short-term borrowings, for example, those which have a maturity period of three months or less.
- 35. **Cash flows arising from each of the following activities of a public financial institution may be reported on a net basis:**
  - (a) **Cash receipts and payments for the acceptance and repayment of deposits with a fixed maturity date;**

- (b) **The placement of deposits with and withdrawal of deposits from other financial institutions; and**
- (c) **Cash advances and loans made to customers and the repayment of those advances and loans.**

### **Foreign Currency Cash Flows**

- 36. **Cash flows arising from transactions in a foreign currency shall be recorded in an entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.**
- 37. **The cash flows of a foreign controlled entity shall be translated at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.**
- 38. Cash flows denominated in a foreign currency are reported in a manner consistent with IPSAS 4, "The Effects of Changes in Foreign Exchange Rates." This permits the use of an exchange rate that approximates the actual rate. For example, a weighted average exchange rate for a period may be used for recording foreign currency transactions or the translation of the cash flows of a foreign controlled entity. IPSAS 4 does not permit the use of the exchange rate at reporting date when translating the cash flows of a foreign controlled entity.
- 39. Unrealized gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency is reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. This amount is presented separately from cash flows from operating, investing and financing activities and includes the differences, if any, had those cash flows been reported at end of period exchange rates.

### **Interest and Dividends**

- 40. **Cash flows from interest and dividends received and paid should each be disclosed separately. Each should be classified in a consistent manner from period to period as either operating, investing or financing activities.**
- 41. The total amount of interest paid during a period is disclosed in the cash flow statement whether it has been recognized as an expense in the statement of financial performance or capitalized in accordance with the allowed alternative treatment in IPSAS 5, "Borrowing Costs."
- 42. Interest paid and interest and dividends received are usually classified as operating cash flows for a public financial institution. However, there is no

consensus on the classification of these cash flows for other entities. Interest paid and interest and dividends received may be classified as operating cash flows because they enter into the determination of net surplus or deficit. Alternatively, interest paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

43. Dividends paid may be classified as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, dividends paid may be classified as a component of cash flows from operating activities in order to assist users to determine the ability of an entity to make these payments out of operating cash flows.

### **Taxes on Net Surplus**

44. **Cash flows arising from taxes on net surplus should be separately disclosed and should be classified as cash flows from operating activities unless they can be specifically identified with financing and investing activities.**
45. Public sector entities are generally exempt from taxes on net surpluses. However, some public sector entities may operate under tax equivalent regimes where taxes are levied in the same way as they are on private sector entities.
46. Taxes on net surplus arise from transactions that give rise to cash flows that are classified as operating, investing or financing activities in a cash flow statement. While tax expense may be readily identifiable with investing or financing activities, the related tax cash flows are often impracticable to identify and may arise in a different period from the cash flows of the underlying transaction. Therefore, taxes paid are usually classified as cash flows from operating activities. However, when it is practicable to identify the tax cash flow with an individual transaction that gives rise to cash flows that are classified as investing or financing activities the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated over more than one class of activity, the total amount of taxes paid is disclosed.

### **Investments in Controlled Entities, Associates and Joint Ventures**

47. When accounting for an investment in an associate or a controlled entity accounted for by use of the equity or cost method, an investor restricts its reporting in the cash flow statement to the cash flows between itself and the investee, for example, to dividends and advances.
48. An entity which reports its interest in a jointly controlled entity using proportionate consolidation, includes in its consolidated cash flow statement

its proportionate share of the jointly controlled entity's cash flows. An entity which reports such an interest using the equity method includes in its cash flow statement the cash flows in respect of its investments in the jointly controlled entity, and distributions and other payments or receipts between it and the jointly controlled entity.

### **Acquisitions and Disposals of Controlled Entities and Other Operating Units**

49. **The aggregate cash flows arising from acquisitions and from disposals of controlled entities or other operating units should be presented separately and classified as investing activities.**
50. **An entity should disclose, in aggregate, in respect of both acquisitions and disposals of controlled entities or other operating units during the period, each of the following:**
  - (a) **The total purchase or disposal consideration;**
  - (b) **The portion of the purchase or disposal consideration discharged by means of cash and cash equivalents;**
  - (c) **The amount of cash and cash equivalents in the controlled entity or operating unit acquired or disposed of; and**
  - (d) **The amount of the assets and liabilities other than cash or cash equivalents recognized by the controlled entity or operating unit acquired or disposed of, summarized by each major category.**
51. The separate presentation of the cash flow effects of acquisitions and disposals of controlled entities and other operating units as single line items, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from the cash flows arising from the other operating, investing and financing activities. The cash flow effects of disposals are not deducted from those acquisitions.
52. The aggregate amount of the cash paid or received as purchase or sale consideration is reported in the cash flow statement net of cash and cash equivalents acquired or disposed of.
53. Assets and liabilities other than cash or cash equivalents of a controlled entity or operating unit acquired or disposed of are only required to be disclosed where the controlled entity or unit had previously recognized those assets or liabilities. For example, where a public sector entity which prepares reports under the cash basis is acquired by another public sector entity, the acquiring entity would not be required to disclose the assets and liabilities (other than cash and cash equivalents) of the entity acquired as that entity would not have recognized noncash assets or liabilities.

## Noncash Transactions

54. **Investing and financing transactions that do not require the use of cash or cash equivalents should be excluded from a cash flow statement. Such transactions should be disclosed elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.**
55. Many investing and financing activities do not have a direct impact on current cash flows although they do affect the capital and asset structure of an entity. The exclusion of noncash transactions from the cash flow statement is consistent with the objective of a cash flow statement as these items do not involve cash flows in the current period. Examples of noncash transactions are:
- (a) The acquisition of assets through the exchange of assets, the assumption of directly related liabilities or by means of a finance lease; and
  - (b) The conversion of debt to equity.

## Components of Cash and Cash Equivalents

56. **An entity should disclose the components of cash and cash equivalents and should present a reconciliation of the amounts in its cash flow statement with the equivalent items reported in the statement of financial position.**
57. In view of the variety of cash management practices and banking arrangements around the world and in order to comply with IPSAS 1 an entity discloses the policy which it adopts in determining the composition of cash and cash equivalents.
58. The effect of any change in the policy for determining components of cash and cash equivalents, for example, a change in the classification of financial instruments previously considered to be part of an entity's investment portfolio, is reported in accordance with IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors."

## Other Disclosures

59. **An entity should disclose, together with a commentary by management in the notes to the financial statements, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the economic entity.**
60. There are various circumstances in which cash and cash equivalent balances held by an entity are not available for use by the economic entity. Examples include cash and cash equivalent balances held by a controlled entity that

operates in a country where exchange controls or other legal restrictions apply when the balances are not available for general use by the controlling entity or other controlled entities.

61. Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a description in the notes to the financial statements, is encouraged and may include:
  - (a) The amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;
  - (b) The aggregate amounts of the cash flows from each of operating, investing and financing activities related to interests in joint ventures reported using proportionate consolidation; and
  - (c) The amount and nature of restricted cash balances.
62. Where appropriations or budget authorizations are prepared on a cash basis, the cash flow statement may assist users in understanding the relationship between the entity's activities or programs and the government's budgetary information. Refer to IPSAS 1 for a brief discussion of the comparison of actual and budgeted figures.

### **Effective Date**

63. **This IPSAS becomes effective for annual financial statements covering periods beginning on or after July 1, 2001. Earlier application is encouraged.**
64. When an entity adopts the accrual basis of accounting, as defined by IPSASs, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

## Appendix

**Cash Flow Statement (For an Entity Other Than a Financial Institution)**

*This appendix is illustrative only and does not form part of the standards. The purpose of this appendix is to illustrate the application of the standards to assist in clarifying their meaning.*

**Direct Method Cash Flow Statement (paragraph 27(a))****Public Sector Entity—Consolidated Cash Flow Statement for Year Ended December 31 20X2 (In Thousands of Currency Units)**

	20X2	20X1
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
<b>Receipts</b>		
Taxation	X	X
Sales of goods and services	X	X
Grants	X	X
Interest received	X	X
Other receipts	X	X
<b>Payments</b>		
Employee costs	(X)	(X)
Superannuation	(X)	(X)
Suppliers	(X)	(X)
Interest paid	(X)	(X)
Other payments	(X)	(X)
<b>Net cash flows from operating activities</b>	<u>X</u>	<u>X</u>
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Purchase of plant and equipment	(X)	(X)
Proceeds from sale of plant and equipment	X	X
Proceeds from sale of investments	X	X
Purchase of foreign currency securities	(X)	(X)
<b>Net cash flows from investing activities</b>	<u>(X)</u>	<u>(X)</u>

CASH FLOW STATEMENTS

**CASH FLOWS FROM FINANCING ACTIVITIES**

Proceeds from borrowings	X	X
Repayment of borrowings	(X)	(X)
Distribution/dividend to government	(X)	(X)
<b>Net cash flows from financing activities</b>	<u>X</u>	<u>X</u>
<b>Net increase/(decrease) in cash and cash equivalents</b>	X	X
<b>Cash and cash equivalents at beginning of period</b>	<u>X</u>	<u>X</u>
<b>Cash and cash equivalents at end of period</b>	<u><u>X</u></u>	<u><u>X</u></u>

**Notes to the Cash Flow Statement**

(a) *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash on hand and balances with banks and investments in money market instruments. Cash and cash equivalents included in the cash flow statement comprise the following statement of financial position amounts:

	<b>20X2</b>	<b>20X1</b>
Cash on hand and balances with banks	X	X
Short-term investments	<u>X</u>	<u>X</u>
	<u><u>X</u></u>	<u><u>X</u></u>

The entity has undrawn borrowing facilities of X, of which X must be used on infrastructure projects.

(b) *Property, Plant and Equipment*

During the period, the economic entity acquired property, plant and equipment with an aggregate cost of X of which X was acquired by means of capital grants by the national government. Cash payments of X were made to purchase property, plant and equipment.

(c) *Reconciliation of Net Cash Flows from Operating Activities to Net Surplus/(Deficit) from Ordinary Activities (in thousands of currency units)*

**Direct Method Cash Flow Statement (paragraph 27(a))****Notes to the Cash Flow Statement****(d) Reconciliation of Net Cash Flows from Operating Activities to Surplus/ (Deficit)**

(in thousands of currency units)	<b>20X2</b>	<b>20X1</b>
<b>Surplus/(deficit) from ordinary activities</b>	X	X
<b>Noncash movements</b>		
Depreciation	X	X
Amortization	X	X
Increase in provision for doubtful debts	X	X
Increase in payables	X	X
Increase in borrowings	X	X
Increase in provisions relating to employee costs	X	X
(Gains)/losses on sale of property, plant and equipment	(X)	(X)
(Gains)/losses on sale of investments	(X)	(X)
Increase in other current assets	(X)	(X)
Increase in investments due to revaluation	(X)	(X)
Increase in receivables	(X)	(X)
<b>Net cash flows from operating activities</b>	<b>X</b>	<b>X</b>

**Indirect Method Cash Flow Statement (paragraph 27(b))**

**Public Sector Entity—Consolidated Cash Flow Statement for Year Ended  
December 31, 20X2 (In Thousands of Currency Units)**

(in thousands of currency units)	<b>20X2</b>	<b>20X1</b>
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Surplus/(deficit)	X	X
<b>Noncash movements</b>		
Depreciation	X	X
Amortization	X	X
Increase in provision for doubtful debts	X	X
Increase in payables	X	X
Increase in borrowings	X	X
Increase in provisions relating to employee costs	X	X
(Gains)/losses on sale of property, plant and equipment	(X)	(X)
(Gains)/losses on sale of investments	(X)	(X)
Increase in other current assets	(X)	(X)
Increase in investments due to revaluation	(X)	(X)
Increase in receivables	(X)	(X)
<b>Net cash flows from operating activities</b>	<b>X</b>	<b>X</b>

**Notes to the Cash Flow Statement**(a) *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash on hand and balances with banks and investments in money market instruments. Cash and cash equivalents included in the cash flow statement comprise the following statement of financial position amounts:

	<b>20X2</b>	<b>20X1</b>
Cash on hand and balances with banks	X	X
Short-term investments	<u>X</u>	<u>X</u>
	<u><u>X</u></u>	<u><u>X</u></u>

The entity has undrawn borrowing facilities of X, of which X must be used on infrastructure projects.

(b) *Property, Plant and Equipment*

During the period, the economic entity acquired property, plant and equipment with an aggregate cost of X of which X was acquired by means of capital grants by the national government. Cash payments of X were made to purchase property, plant and equipment.

### **Comparison with IAS 7**

IPSAS 2, “Cash Flow Statements,” is drawn primarily from IAS 7, “Cash Flow Statements.” The main differences between IPSAS 2 and IAS 7 are as follows:

- Commentary additional to that in IAS 7 has been included in IPSAS 2 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 2 uses different terminology, in certain instances, from IAS 7. The most significant examples are the use of the terms entity, revenue, statement of financial performance, statement of financial position and net assets/equity in IPSAS 2. The equivalent terms in IAS 7 are enterprise, income, income statement, balance sheet and equity.
- IPSAS 2 contains a different set of definitions of technical terms from IAS 7 (paragraph 8).
- In common with IAS 7, IPSAS 2 allows either the direct or indirect method to be used to present cash flows from operating activities. Where the direct method is used to present cash flows from operating activities, IPSAS 2 encourages disclosure of a reconciliation of surplus or deficit to operating cash flows in the notes to the financial statements (paragraph 29).
- The Appendix to IPSAS 2 does not include an illustration of a Cash Flow Statement for a financial institution.

## **IPSAS 3—ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 8 (Revised December 2003), “Accounting Policies, Changes in Accounting Estimates and Errors” published by the International Accounting Standards Board (IASB). Extracts from IAS 8 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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**IPSAS 3—ACCOUNTING POLICIES, CHANGES IN  
ACCOUNTING ESTIMATES AND ERRORS**

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IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” is set out in paragraphs 1–61 and the Appendix. All the paragraphs have equal authority. IPSAS 3 should be read in the context of its objective and the Basis for Conclusions, and the “Preface to the International Public Sector Accounting Standards.”

## **Introduction**

IN1. IPSAS 3, “Accounting Policies, Changes in Estimates and Errors,” replaces IPSAS 3, “Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies” (issued May 2000), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## **Reasons for Revising IPSAS 3**

IN2. The IPSASB developed this revised IPSAS 3 as a response to the IASB’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 3, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 8, “Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 8 for a public sector specific reason; such variances are retained in this IPSAS 3 and are noted in the Comparison with IAS 8. Any changes to IAS 8 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 3.

## **Changes from Previous Requirements**

IN4. The main changes from the previous version of IPSAS 3 are described below.

### **Name of Standard**

IN5. The Standard is called “Accounting Policies, Changes in Accounting Estimates and Errors.”

### **Scope**

IN6. The Standard includes criteria for the selection of accounting policies that were previously contained in IPSAS 1, “Presentation of Financial Statements”; and

IN7. The Standard does not contain requirements on the presentation of items in the statement of financial performance, which are now included in IPSAS 1.

### **Definitions**

IN8. The Standard defines new terms: change in accounting estimate, prior period errors, prospective application, retrospective application and retrospective restatement, impracticable, material and notes.

IN9. The Standard does not include definitions of the terms: extraordinary items, ordinary activities, net surplus/deficit, and surplus/deficit from ordinary activities, which are no longer required.

### **Materiality**

IN10. The Standard stipulates that:

- The accounting policies in IPSASs need not be applied when the effect of applying them is immaterial; and
- Financial statements do not comply with IPSASs if they contain material errors.

### **Net Surplus or Deficit for the Period**

IN11. The Standard does not include the requirements for the presentation of surplus or deficit for the period that were included in the superseded IPSAS 3, these requirements are now included in IPSAS 1.

### **Accounting Policies**

IN12. The Standard specifies the hierarchy of IPSASB's pronouncements, and authoritative and non-mandatory guidance, to be considered when selecting accounting policies to apply in the preparation of financial statements. The new hierarchy is now established as a principle and printed in bold type.

IN13. The Standard does not include the allowed alternative treatments for changes in accounting policies (including voluntary changes) that were included in the superseded IPSAS 3. An entity is now required (where practicable) to account for changes in accounting policies retrospectively.

### **Errors**

IN14. The Standard does not distinguish between fundamental errors and other material errors.

IN15. The Standard does not include the allowed alternative treatments for the correction of errors that were included in the superseded IPSAS 3. An entity is now required to correct (where practicable) material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery.

### **Criteria for Exemptions from Requirements (Impracticability)**

IN16. The Standard requires that when it is impracticable to determine the cumulative effect, at the beginning of the current period, of:

- Applying a new accounting policy to all prior periods, or
- An error on all prior periods,

The entity changes the comparative information as if the new accounting policy had always been applied; or the error had been corrected, prospectively from the earliest date practicable.

IN17. The Standard includes guidance on the interpretation of impracticable.

### **Disclosures**

IN18. The Standard requires more detailed and additional disclosure of the amounts of adjustments as a consequence of changing accounting policies or correcting prior period errors than was required by the superseded IPSAS 3.

IN19. The Standard requires, rather than encourages the disclosure of:

- An impending change in accounting policy when an entity has yet to adopt a new IPSAS which has been published but not yet come into effect; and
- Known or reasonably estimable information relevant to assessing the possible impact that application of the new IPSAS will have on the entity's financial statements in the period of initial application.

### **Amendments to Other Pronouncements**

IN20. The Standard includes an authoritative appendix of amendments to other IPSASs that are not part of the IPSASs Improvements project and will be impacted as a result of the proposals in this IPSAS.

## IPSAS 3—ACCOUNTING POLICIES, CHANGES IN ACCOUNTING ESTIMATES AND ERRORS

### Objective

1. The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the accounting treatment and disclosure of changes in accounting policies, changes in accounting estimates and the corrections of errors. This Standard is intended to enhance the relevance and reliability of an entity's financial statements, and the comparability of those financial statements over time and with the financial statements of other entities.
2. Disclosure requirements for accounting policies, except those for changes in accounting policies, are set out in IPSAS 1.

### Scope

3. **This Standard shall be applied in selecting and applying accounting policies, and accounting for changes in accounting policies, changes in accounting estimates and corrections of prior period errors.**
4. The tax effects of corrections of prior period errors and of retrospective adjustments made to apply changes in accounting policies are not considered in this Standard as they are not relevant for many public sector entities. International or national accounting standards dealing with income taxes contain guidance on the treatment of tax effects.
5. **This Standard applies to all public sector entities other than Government Business Enterprises.**
6. The “Preface to International Public Sector Accounting Standards” issued by the IPSASB explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the IASB. GBEs are defined in IPSAS 1.

### Definitions

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

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

**Accrual basis** means a basis of accounting under which transactions, other events and conditions are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions, other events and conditions are recorded in the accounting records and recognized in the financial statements of the periods to which

they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.

A **change in accounting estimate** is an adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not correction of errors.

**Impracticable.** Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:

- (a) The effects of the retrospective application or retrospective restatement are not determinable;
- (b) The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
- (c) The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
  - (i) Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured or disclosed; and
  - (ii) Would have been available when the financial statements for that prior period were authorized for issue

from other information.

**Material Omissions** or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.

**Prior period errors** are omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

- (a) Was available when financial statements for those periods were authorized for issue; and

- (b) **Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.**

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

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

- (a) **Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and**
- (b) **Recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change.**

**Retrospective application is applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.**

**Retrospective restatement is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.**

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

### **Materiality**

8. Assessing whether an omission or misstatement could influence decisions of users, and so be material, requires consideration of the characteristics of those users. Users are assumed to have a reasonable knowledge of the public sector and economic activities and accounting and a willingness to study the information with reasonable diligence. Therefore, the assessment needs to take into account how users with such attributes could reasonably be expected to be influenced in making and evaluating decisions.

## **Accounting Policies**

### **Selection and Application of Accounting Policies**

9. **When an IPSAS specifically applies to a transaction, other event or condition, the accounting policy or policies applied to that item shall be determined by applying the Standard and considering any relevant Implementation Guidance issued by the IPSASB for the Standard.**
10. IPSASs set out accounting policies that the IPSASB has concluded result in financial statements containing relevant and reliable information about the

transactions, other events and conditions to which they apply. Those policies need not be applied when the effect of applying them is immaterial. However, it is inappropriate to make, or leave uncorrected, immaterial departures from IPSASs to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

11. Implementation Guidance for Standards issued by the IPSASB does not form part of those Standards, and therefore does not contain requirements for financial statements.
12. **In the absence of an IPSAS that specifically applies to a transaction, other event or condition, management shall use its judgment in developing and applying an accounting policy that results in information that is:**
  - (a) **Relevant to the decision-making needs of users; and**
  - (b) **Reliable, in that the financial statements:**
    - (i) **Represent faithfully the financial position, financial performance and cash flows of the entity;**
    - (ii) **Reflect the economic substance of transactions, other events and conditions and not merely the legal form;**
    - (iii) **Are neutral i.e., free from bias;**
    - (iv) **Are prudent; and**
    - (v) **Are complete in all material respects.**
13. Paragraph 12 requires the development of accounting policies to ensure that the financial statements provide information that meets a number of qualitative characteristics. Appendix B in IPSAS 1 summarizes the qualitative characteristics of financial reporting.
14. **In making the judgment, described in paragraph 12, management shall refer to, and consider the applicability of, the following sources in descending order:**
  - (a) **The requirements and guidance in IPSASs dealing with similar and related issues; and**
  - (b) **The definitions, recognition and measurement criteria for assets, liabilities, revenue and expenses described in other IPSASs.**
15. **In making the judgment described in paragraph 12, management may also consider the most recent pronouncements of other standard-setting bodies and accepted public or private sector practices to the extent, but only to the extent, that these do not conflict with the sources in paragraph 14. For example, pronouncements of the IASB, including the "Framework for the Preparation and Presentation of Financial**

Statements,” IFRSs and Interpretations issued by the IASB’s International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

#### Consistency of Accounting Policies

16. **An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless an IPSAS specifically requires or permits categorization of items for which different policies may be appropriate. If a Standard requires or permits such categorization, an appropriate accounting policy shall be selected and applied consistently to each category.**

#### Changes in Accounting Policies

17. **An entity shall change an accounting policy only if the change:**
  - (a) **Is required by an IPSAS; or**
  - (b) **Results in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the entity’s financial position, financial performance or cash flows.**
18. Users of financial statements need to be able to compare the financial statements of an entity over time to identify trends in its financial position, performance and cash flows. Therefore, the same accounting policies are applied within each period and from one period to the next unless a change in accounting policy meets one of the criteria in paragraph 17.
19. **A change from one basis of accounting to another basis of accounting is a change in accounting policy.**
20. **A change in the accounting treatment, recognition or measurement of a transaction, event or condition within a basis of accounting is regarded as a change in accounting policy.**
21. **The following are not changes in accounting policies:**
  - (a) **The application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and**
  - (b) **The application of a new accounting policy for transactions, other events or conditions that did not occur previously or that were immaterial.**
22. **The initial application of a policy to revalue assets in accordance with IPSAS 17, “Property, Plant and Equipment” or the relevant international or national accounting standard dealing with intangible assets is a change in accounting policy to be dealt with as a revaluation in**

**accordance with IPSAS 17 or that relevant Standard, rather than in accordance with this Standard.**

23. Paragraphs 24–36 do not apply to the change in accounting policy described in paragraph 22.

#### **Applying Changes in Accounting Policies**

24. **Subject to paragraph 28:**

- (a) **An entity shall account for a change in accounting policy resulting from the initial application of an IPSAS in accordance with the specific transitional provisions, if any, in that Standard; and**
- (b) **When an entity changes an accounting policy upon initial application of an IPSAS that does not include specific transitional provisions applying to that change, or changes an accounting policy voluntarily, it shall apply the change retrospectively.**

25. For the purpose of this IPSAS, early application of a Standard is not a voluntary change in accounting policy.
26. In the absence of an IPSAS that specifically applies to a transaction, other event or condition, management may, in accordance with paragraph 15, apply an accounting policy from the most recent pronouncements of other standard setting bodies and accepted public or private sector practices to the extent, but only to the extent, that these are consistent with paragraph 14. For example, pronouncements of the IASB, including the “Framework for the Preparation and Presentation of Financial Statements”, IFRSs and Interpretations issued by the IFRIC or the former SIC. If, following an amendment of such a pronouncement, the entity chooses to change an accounting policy, that change is accounted for and disclosed as a voluntary change in accounting policy.

#### *Retrospective Application*

27. **Subject to paragraph 28, when a change in accounting policy is applied retrospectively in accordance with paragraph 24(a) or (b), the entity shall adjust the opening balance of each affected component of net assets/equity for the earliest period presented and the other comparative amounts disclosed for each prior period presented as if the new accounting policy had always been applied.**

#### *Limitations on Retrospective Application*

28. **When retrospective application is required by paragraph 24(a) or (b), a change in accounting policy shall be applied retrospectively except to the extent that it is impracticable to determine either the period specific effects or the cumulative effect of the change.**

29. **When it is impracticable to determine the period specific effects of changing an accounting policy on comparative information for one or more prior periods presented, the entity shall apply the new accounting policy to the carrying amounts of assets and liabilities as at the beginning of the earliest period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of net assets/equity for that period.**
30. **When it is impracticable to determine the cumulative effect, at the beginning of the current period, of applying a new accounting policy to all prior periods, the entity shall adjust the comparative information to apply the new accounting policy prospectively from the earliest date practicable.**
31. When an entity applies a new accounting policy retrospectively, it applies the new accounting policy to comparative information for prior periods as far back as is practicable. Retrospective application to a prior period is not practicable unless it is practicable to determine the cumulative effect on the amounts in both the opening and closing statement of financial positions for that period. The amount of the resulting adjustment relating to periods before those presented in the financial statements is made to the opening balance of each affected component of net assets/equity of the earliest prior period presented. Usually the adjustment is made to accumulated surpluses or deficits. However, the adjustment may be made to another component of net assets/equity (for example, to comply with an IPSAS). Any other information about prior periods, such as historical summaries of financial data, is also adjusted as far back as is practicable.
32. When it is impracticable for an entity to apply a new accounting policy retrospectively, because it cannot determine the cumulative effect of applying the policy to all prior periods, the entity, in accordance with paragraph 30, applies the new policy prospectively from the start of the earliest period practicable. It therefore disregards the portion of the cumulative adjustment to assets, liabilities and net assets/equity arising before that date. Changing an accounting policy is permitted even if it is impracticable to apply the policy prospectively for any prior period. Paragraphs 55–58 provide guidance when it is impracticable to apply a new accounting policy to one or more prior periods.

#### **Disclosure**

33. **When initial application of an IPSAS has an effect on the current period or any prior period, would have such an effect except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:**
- (a) **The title of the Standard;**

- (b) **When applicable, that the change in accounting policy is made in accordance with its transitional provisions;**
- (c) **The nature of the change in accounting policy;**
- (d) **When applicable, a description of the transitional provisions;**
- (e) **When applicable, the transitional provisions that might have an effect on future periods;**
- (f) **For the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;**
- (g) **The amount of the adjustment relating to periods before those presented, to the extent practicable; and**
- (h) **If retrospective application required by paragraph 24(a) or (b) is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.**

**Financial statements of subsequent periods need not repeat these disclosures.**

34. **When a voluntary change in accounting policy has an effect on the current period or any prior period, would have an effect on that period except that it is impracticable to determine the amount of the adjustment, or might have an effect on future periods, an entity shall disclose:**

- (a) **The nature of the change in accounting policy;**
- (b) **The reasons why applying the new accounting policy provides reliable and more relevant information;**
- (c) **For the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;**
- (d) **The amount of the adjustment relating to periods before those presented, to the extent practicable; and**
- (e) **If retrospective application is impracticable for a particular prior period, or for periods before those presented, the circumstances that led to the existence of that condition and a description of how and from when the change in accounting policy has been applied.**

**Financial statements of subsequent periods need not repeat these disclosures.**

35. **When an entity has not applied a new IPSAS that has been issued but is not yet effective, the entity shall disclose:**
- (a) **This fact; and**
  - (b) **Known or reasonably estimable information relevant to assessing the possible impact that application of the new Standard will have on the entity's financial statements in the period of initial application.**
36. In complying with paragraph 35, an entity considers disclosing:
- (a) The title of the new IPSAS;
  - (b) The nature of the impending change or changes in accounting policy;
  - (c) The date by which application of the Standard is required;
  - (d) The date as at which it plans to apply the Standard initially; and
  - (e) Either:
    - (i) A discussion of the impact that initial application of the Standard is expected to have on the entity's financial statements; or
    - (ii) If that impact is not known or reasonably estimable, a statement to that effect.

### **Changes in Accounting Estimates**

37. As a result of the uncertainties inherent in delivering services, conducting trading or other activities, many items in financial statements cannot be measured with precision but can only be estimated. Estimation involves judgments based on the latest available, reliable information. For example, estimates may be required, of:
- (a) Tax revenue due to government;
  - (b) Bad debts arising from uncollected taxes;
  - (c) Inventory obsolescence;
  - (d) The fair value of financial assets or financial liabilities;
  - (e) The useful lives of, or expected pattern of consumption of future economic benefits or service potential embodied in depreciable assets, or the percentage completion of road construction; and
  - (f) Warranty obligations.
38. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

39. An estimate may need revision if changes occur in the circumstances on which the estimate was based or as a result of new information or more experience. By its nature, the revision of an estimate does not relate to prior periods and is not the correction of an error.
40. A change in the measurement basis applied is a change in an accounting policy, and is not a change in an accounting estimate. When it is difficult to distinguish a change in an accounting policy from a change in an accounting estimate, the change is treated as a change in an accounting estimate.
41. **The effect of a change in an accounting estimate, other than a change to which paragraph 42 applies, shall be recognized prospectively by including it in surplus or deficit in:**
- (a) **The period of the change, if the change affects the period only; or**
  - (b) **The period of the change and future periods, if the change affects both.**
42. **To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of net assets/equity, it shall be recognized by adjusting the carrying amount of the related asset, liability or net assets/equity item in the period of change.**
43. Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events and conditions from the date of the change in estimate. A change in an accounting estimate may affect only the current period's surplus or deficit, or the surplus or deficit of both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period's surplus or deficit and therefore is recognized in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of economic benefits or service potential embodied in a depreciable asset affects the depreciation expense for the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognized as revenue or expense in the current period. The effect, if any, on future periods is recognized in future periods.

#### **Disclosure**

44. **An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect on future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.**
45. **If the amount of the effect in future periods is not disclosed because estimating it is impracticable, the entity shall disclose that fact.**

## Errors

46. Errors can arise in respect of the recognition, measurement, presentation or disclosure of elements of financial statements. Financial statements do not comply with IPSASs if they contain either material errors or immaterial errors made intentionally to achieve a particular presentation of an entity's financial position, financial performance or cash flows. Potential current period errors discovered in that period are corrected before the financial statements are authorized for issue. However, material errors are sometimes not discovered until a subsequent period, and these prior period errors are corrected in the comparative information presented in the financial statements for that subsequent period (see paragraphs 47–51).
47. **Subject to paragraph 48, an entity shall correct material prior period errors retrospectively in the first set of financial statements authorized for issue after their discovery by:**
- (a) **Restating the comparative amounts for prior period(s) presented in which the error occurred; or**
  - (b) **If the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and net assets/equity for the earliest prior period presented.**

### Limitations of Retrospective Restatement

48. **A prior period error shall be corrected by retrospective restatement except to the extent that it is impracticable to determine either the period specific effects or the cumulative effect of the error.**
49. **When it is impracticable to determine the period specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and net assets/equity for the earliest period for which retrospective restatement is practicable (which may be the current period).**
50. **When it is impracticable to determine the cumulative effect, at the beginning of the current period, of an error on all prior periods, the entity shall restate the comparative information to correct the error prospectively from the earliest date practicable.**
51. The correction of a prior period error is excluded from surplus or deficit for the period in which the error is discovered. Any information presented about prior periods, including historical summaries of financial data, is also restated as far back as is practicable.
52. When it is impracticable to determine the amount of an error (e.g., a mistake in applying an accounting policy) for all prior periods, the entity, in accordance with paragraph 50, restates the comparative information

prospectively from the earliest date practicable. It therefore disregards the portion of the cumulative restatement of assets, liabilities and net assets/equity arising before that date. Paragraphs 55–58 provide guidance on when it is impracticable to correct an error for one or more prior periods.

53. Corrections of errors are distinguished from changes in accounting estimates. Accounting estimates by their nature are approximations that may need revision as additional information becomes known. For example, the gain or loss recognized on the outcome of a contingency is not the correction of an error.

#### **Disclosure of Prior Period Errors**

54. **In applying paragraph 47, an entity shall disclose the following:**
- (a) **The nature of the prior period error;**
  - (b) **For each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected;**
  - (c) **The amount of the correction at the beginning of the earliest prior period presented; and**
  - (d) **If retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.**

**Financial statements of subsequent periods need not repeat these disclosures.**

#### **Impracticability in Respect of Retrospective Application and Retrospective Restatement**

55. In some circumstances, it is impracticable to adjust comparative information for one or more prior periods to achieve comparability with the current period. For example, data may not have been collected in the prior period(s) in a way that allows either retrospective application of a new accounting policy (including, for the purpose of paragraphs 56–58, its prospective application to prior periods) or retrospective restatement to correct a prior period error, and it may be impracticable to recreate the information.
56. It is frequently necessary to make estimates in applying an accounting policy to elements of financial statements recognized or disclosed in respect of transactions, other events or conditions. Estimation is inherently subjective, and estimates may be developed after the reporting date. Developing estimates is potentially more difficult when retrospectively applying an accounting policy or making a retrospective restatement to correct a prior period error, because of the longer period of time that might have passed since the affected transaction, other event or condition occurred. However, the objective of estimates related to prior

periods remains the same as for estimates made in the current period, namely, for the estimate to reflect the circumstances that existed when the transaction, other event or condition occurred.

57. Therefore, retrospectively applying a new accounting policy or correcting a prior period error requires distinguishing information that:
- (a) Provides evidence of circumstances that existed on the date(s) as at which the transaction, other event or condition occurred, and
  - (b) Would have been available when the financial statements for that prior period were authorized for issue.

from other information. For some types of estimates (e.g., an estimate of fair value not based on an observable price or observable inputs), it is impracticable to distinguish these types of information. When retrospective application or retrospective restatement would require making a significant estimate for which it is impossible to distinguish these two types of information, it is impracticable to apply the new accounting policy or correct the prior period error retrospectively.

58. Hindsight should not be used when applying a new accounting policy to, or correcting amounts for, a prior period, either in making assumptions about what management's intentions would have been in a prior period or estimating the amounts recognized, measured or disclosed in a prior period. For example, when an entity corrects a prior period error in classifying a government building as an investment property (the building was previously classified as property, plant and equipment), it does not change the basis of classification for that period, if management decided later to use that building as an owner occupied office building. In addition, when an entity corrects a prior period error in calculating its liability for provision of cleaning costs of pollution resulting from government operations in accordance with IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets," it disregards information about an unusually large oil leak from a naval supply ship during the next period that became available after the financial statements for the prior period were authorized for issue. The fact that significant estimates are frequently required when amending comparative information presented for prior periods does not prevent reliable adjustment or correction of the comparative information.

### Effective Date

59. **An entity shall apply this IPSAS for annual periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**

60. When an entity adopts the accrual basis of accounting, as defined by IPSASs, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

**Withdrawal of IPSAS 3 (issued 2000)**

61. This Standard supersedes IPSAS 3, "Net Surplus or Deficit for the Period, Fundamental Errors and Changes in Accounting Policies" issued in 2000.

## Appendix

**Amendments to Other Pronouncements**

*The amendments in this appendix shall be applied for annual periods beginning on or after January 1, 2008. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.*

A1. IPSAS 2, “Cash Flow Statements” is amended as follows:

Paragraphs 40 and 41 on extraordinary items are deleted.

The Appendix in IPSAS 2 which illustrates a cash flow statement for an entity, is amended to remove an extraordinary item. The revised Appendix is set out below.

**Direct Method Cash Flow Statement (paragraph 27(a))****Notes to the Cash Flow Statement***Reconciliation of Net Cash Flows from Operating Activities to Surplus/ (Deficit)*

(in thousands of currency units)	20X2	20X1
<b>Surplus/(deficit) from ordinary activities</b>	X	X
<b>Noncash movements</b>		
Depreciation	X	X
Amortization	X	X
Increase in provision for doubtful debts	X	X
Increase in payables	X	X
Increase in borrowings	X	X
Increase in provisions relating to employee costs	X	X
(Gains)/losses on sale of property, plant and equipment	(X)	(X)
(Gains)/losses on sale of investments	(X)	(X)
Increase in other current assets	(X)	(X)
Increase in investments due to revaluation	(X)	(X)
Increase in receivables	(X)	(X)
<b>Net cash flows from operating activities</b>	<b>X</b>	<b>X</b>

**Indirect Method Cash Flow Statement (paragraph 27(b))****Public Sector Entity—Consolidated Cash Flow Statement for Year Ended December 31, 20X2 (In Thousands of Currency Units)**

(in thousands of currency units)	20X2	20X1
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Surplus/(deficit)	X	X
<b>Noncash movements</b>		
Depreciation	X	X
Amortization	X	X
Increase in provision for doubtful debts	X	X
Increase in payables	X	X
Increase in borrowings	X	X
Increase in provisions relating to employee costs	X	X
(Gains)/losses on sale of property, plant and equipment	(X)	(X)
(Gains)/losses on sale of investments	(X)	(X)
Increase in other current assets	(X)	(X)
Increase in investments due to revaluation	(X)	(X)
Increase in receivables	(X)	(X)
<b>Net cash flows from operating activities</b>	<u><u>X</u></u>	<u><u>X</u></u>

A2. IPSAS 18, “Segment Reporting” is amended as described below.

The definition of accounting policies in paragraph 8 is amended to read as follows:

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

Paragraph 57 is amended to read as follows:

57. IPSAS 1 requires that when items of revenue or expense are material, the nature and amount of such items shall be disclosed separately. IPSAS 1 identifies a number of examples of such items, including write-downs of inventories and property, plant, and equipment; provisions for restructurings; disposals of property, plant, and

equipment; privatizations and other disposals of long-term investments; discontinuing operations; litigation settlements; and reversals of provisions. The encouragement in paragraph 56 is not intended to change the classification of any such items or to change the measurement of such items. The disclosure encouraged by that paragraph, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the entity level to the segment level.

Paragraphs 69 and 70 are amended to read as follows:

69. Changes in accounting policies adopted by the entity are dealt with in IPSAS 3. IPSAS 3 requires that changes in accounting policy shall be made by an IPSAS, or if the change will result in reliable and more relevant information about transactions, other events or conditions in the financial statements of the entity.
70. Changes in accounting policies applied at the entity level that affect segment information are dealt with in accordance with IPSAS 3. Unless a new IPSAS specifies otherwise, IPSAS 3 requires that:
  - (a) A change in accounting policy be applied retrospectively and that prior period information be restated unless it is impracticable to determine either the cumulative effect or the period specific effects of the change;
  - (b) If retrospective application is not practicable for all periods presented, the new accounting policy shall be applied retrospectively from the earliest practicable date; and
  - (c) If it is impracticable to determine the cumulative effect of applying the new accounting policy at the start of the current period, the policy shall be applied prospectively from the earliest date practicable.

The following changes are made to remove references to extraordinary items:

- (a) in paragraph 27, in the definition of segment revenue, subparagraph (a) is deleted;
  - (b) in paragraph 27, in the definition of segment expense, subparagraph (a) is deleted; and
  - (c) in Appendix 1, the second last paragraph is deleted.
- A3. In IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets", paragraph 111 is deleted.
  - A4. In IPSASs, applicable at January 1, 2008, references to the current version of IPSAS 3, "Net Profit or Loss for the Period, Fundamental Errors and Changes

in Accounting Policies” are amended to IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.”

## Guidance on Implementing IPSAS 3

*This guidance accompanies, but is not part of, IPSAS 3.*

### Example 1—Retrospective Restatement of Errors

- 1.1. During 20X2, the entity discovered that revenue from income taxes was incorrect. Income taxes of CU<sup>1</sup>6,500 that should have been recognized in 20X1 were incorrectly omitted from 20X1 and recognized as revenue in 20X2.
- 1.2. The entity's accounting records for 20X2 show revenue from taxation of CU60,000 (including the CU6,500 taxation which should have been recognized in opening balances), and expenses of CU86,500.
- 1.3. In 20X1, the entity reported:

	CU
Revenue from taxation	34,000
User charges	3,000
Other operating revenue	<u>30,000</u>
Total revenue	67,000
Expenses	<u>(60,000)</u>
Surplus	<u><u>7,000</u></u>

- 1.4. 20X1 opening accumulated surplus was CU20,000 and closing accumulated surplus was CU27,000.
- 1.5. The entity had no other revenue or expenses.
- 1.6. The entity had CU5,000 of contributed capital throughout, and no other components of net assets/equity except for accumulated surplus.

### Public Sector Entity – Statement of Financial Performance

	(restated)	
	20X2	20X1
	CU	CU
Revenue from taxation	53,500	40,500
User charges	4,000	3,000
Other operating revenue	<u>40,000</u>	<u>30,000</u>
Total revenue	97,500	73,500
Expenses	<u>(86,500)</u>	<u>(60,000)</u>
Surplus	<u><u>11,000</u></u>	<u><u>13,500</u></u>

<sup>1</sup> In these examples, monetary amounts are denominated in "currency units" (CU).

**Public Sector Entity X Statement of Changes in Equity**

	Contributed capital	Accumulate d Surpluses	Total
	CU	CU	CU
Balance at 31 December 20X0	5,000	20,000	15,000
Surplus for the year ended December 31, 20X1 as restated	-	13,500	13,500
Balance at 31 December 20X1	5,000	33,500	38,500
Surplus for the year ended 31 December 20X2	-	11,000	11,000
Balance at 31 December 20X2	5,000	44,500	49,500

*Extracts from Notes to the Financial Statements*

- Revenue from taxation of CU6,500 was incorrectly omitted from the financial statements of 20X1. The financial statements of 20X1 have been restated to correct this error. The effect of the restatement on those financial statements is summarized below. There is no effect in 20X2.

	Effect on 20X1
	CU
Increase revenue	6,500
Increase in surplus	6,500
Increase in debtors	6,500
Increase in net assets/equity	6,500

**Example 2—Change in Accounting Policy with Retrospective Application**

- During 20X2, the entity changed its accounting policy for the treatment of borrowing costs that are directly attributable to the acquisition of a hydro-electric power station which is under construction. In previous periods, the entity had capitalized such costs. The entity has now decided to expense, rather than capitalize them. Management judges that the new policy is preferable because it results in a more transparent treatment of finance costs and is consistent with local industry practice, making the entity's financial statements more comparable.

- 2.2. The entity capitalized borrowing costs incurred of CU2,600 during 20X1 and CU5,200 in periods prior to 20X1. All borrowing costs incurred in previous years with respect to the acquisition of the power station were capitalized.
- 2.3. The accounting records for 20X2 show surplus before interest of CU30,000; and interest expense of CU3,000 (which relates only to 20X2).
- 2.4. The entity has not recognized any depreciation on the power station because it is not yet in use.
- 2.5. In 20X1, the entity reported:

	CU
Surplus before interest	18,000
Interest expense	—
Surplus	<u>18,000</u>

- 2.6. 20X1 opening accumulated surpluses was CU20,000 and closing accumulated surpluses was CU38,000.
- 2.7. The entity had CU10,000 of contributed capital throughout, and no other components of net assets/equity except for accumulated surplus.

#### Public Sector Entity – Statement of Financial Performance

	(restated)	
	20X2	20X1
	CU	CU
Surplus before interest	30,000	18,000
Interest expense	<u>(3,000)</u>	<u>(2,600)</u>
Surplus	<u>27,000</u>	<u>15,400</u>

#### Public Sector Entity – Statement of Changes in Net Assets/Equity

	(restated)		
	Contributed capital	Accumulated Surplus	Total
	CU	CU	CU
Balance at 31 December 20X0 as previously reported	10,000	20,000	30,000
Change in accounting policy with respect to the capitalization of interest (Note 1)	-	(5,200)	(5,200)
Balance at 31 December 20X0 as restated	10,000	14,800	24,800
Surplus for the year ended 31 December 20X1 (restated)	-	15,400	15,400

	(restated)		
	Contributed capital	Accumulated Surplus	Total
Balance at 31 December 20X1	10,000	30,200	40,200
Surplus for the year ended 31 December 20X2	-	27,000	27,000
Closing at 31 December 20X2	10,000	57,200	67,200

### Extracts from the Notes

- During 20X2, the entity changed its accounting policy for the treatment of borrowing costs related to a hydro-electric power station. Previously, the entity capitalized such costs. They are now written off as expenses as incurred. Management judges that this policy provides reliable and more relevant information because it results in a more transparent treatment of finance costs and is consistent with local industry practice, making the entity's financial statements more comparable. This change in accounting policy has been accounted for retrospectively and the comparative statements for 20X1 have been restated. The effect of the change on 20X1 is tabulated below. Opening accumulated surpluses for 20X1 have been reduced by CU5,200 which is the amount of the adjustment relating to periods prior to 20X1.

<i>Effect on 20-1</i>	CU
(Increase) in interest expense	(2,600)
(Decrease) in surplus	(2,600)
<i>Effect on periods prior to 20-1</i>	
(Decrease) in surplus	(5,200)
(Decrease) in assets in the course of construction and in accumulated surplus	(7,800)

### Example 3—Prospective Application of a Change in Accounting Policy When Retrospective Application is not Practicable

- During 20X2, the entity changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model.
- In years before 20X2, the entity's asset records were not sufficiently detailed to apply a components approach fully. At the end of year 20X1, management commissioned an engineering survey, which provided information on the components held and their fair values, useful lives, estimated residual values and depreciable amounts at the beginning of 20X2. However, the survey did not provide a sufficient basis for reliably estimating the cost of those

components that had not previously been accounted for separately, and the existing records before the survey did not permit this information to be reconstructed.

- 3.3. Management considered how to account for each of the two aspects of the accounting change. They determined that it was not practicable to account for the change to a fuller components approach retrospectively, or to account for that change prospectively from any earlier date than the start of 20X2. Also, the change from a cost model to a revaluation model is required to be accounted for prospectively. Therefore, management concluded that it should apply the entity's new policy prospectively from the start of 20X2.

- 3.4. Additional information:

	CU
Property, plant and equipment	
Cost	25,000
Depreciation	<u>(14,000)</u>
Net book value	<u>11,000</u>
Prospective depreciation expense for 20X2 (old basis)	1,500
Some results of the engineering survey	
Valuation	17,000
Estimated residual value	3,000
Average remaining assets life (years)	7
Depreciation expense on existing property, plant and equipment for 20X2 (new basis)	2,000

#### Extract from the Notes

1. From the start of 20X2, the entity changed its accounting policy for depreciating property, plant and equipment, so as to apply much more fully a components approach, whilst at the same time adopting the revaluation model. Management takes the view that this policy provides reliable and more relevant information because it deals more accurately with the components of property, plant and equipment and is based on up-to-date values. The policy has been applied prospectively from the start of 20X2 because it was not practicable to estimate the effects of applying the policy either retrospectively or prospectively from any earlier date. Accordingly the adopting of the new policy has no effect on prior periods. The effect on the current year is to

increase the carrying amount of property, plant and equipment at the start of the year by CU6,000; create a revaluation reserve at the start of the year of CU6,000; and increase depreciation expense by CU500.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.” This Basis for Conclusions only notes the IPSASB’s reasons for departing from provisions of the related International Accounting Standard.*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)’s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB’s work program. The IPSASB’s policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the ‘comparison with IFRS’ included in each IPSAS. The Comparison with IAS 8 references the December 2003 version of IAS 8 and not any other.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB’s General Improvements project were “to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements.” The final IASs were issued in December 2003.
- BC4. IPSAS 3, issued in January 2000 was based on IAS 8 (Revised 1993), “Net Profit or Loss of the Period, Fundamental Errors and Changes in Accounting Policies” which was reissued in December 2003, as IAS 8, “Accounting Policies, Changes in Accounting Estimates and Errors.” In late 2003, the IPSASB’s predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.

<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB’s predecessor – the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC’s mandate to become an independent standard-setting board in November 2004.

- BC5. The IPSASB reviewed the improved IAS 8 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The IASB's Bases for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)).
- BC6. IPSAS 3 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

### Comparison with IAS 8

International Public Sector Accounting Standard IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” is drawn primarily from International Accounting Standard IAS 8 (2003), “Accounting Policies, Changes in Accounting Estimates and Errors.” The main differences between IPSAS 3 and IAS 8 are as follows:

- Commentary additional to that in IAS 8 has been included in IPSAS 3 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 3 uses different terminology, in certain instances, from IAS 8. The most significant examples are the use of the terms statement of financial performance, statement of financial position, accumulated surplus or deficit and net assets/equity in IPSAS 3. The equivalent terms in IAS 8 are income statement, balance sheet, retained earning and equity.
- IPSAS 3 does not use the term income, which in IAS 8 has a broader meaning than the term revenue.
- IPSAS 3 contains a different set of definitions of technical terms from IAS 8 (paragraph 7).
- IPSAS 3 has a similar hierarchy to IAS 8, except that the IPSASB does not have a conceptual framework.
- IPSAS 3 does not require disclosures about adjustments to basic or diluted earnings per share. IAS 8 requires disclosure of amount of adjustment or correction for basic or diluted earnings per share.

## **IPSAS 4—THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 21 (revised in 2003, as amended in 2005), “The Effects of Changes in Foreign Exchange Rates” published by the International Accounting Standards Board (IASB). Extracts from IAS 21 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

The approved text of the IFRSs is that published by the IASB in the English language, and copies may be obtained directly from IASB Publications Department, 30 Cannon Street, London EC4M 6XH, United Kingdom.

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**IPSAS 4—THE EFFECTS OF CHANGES IN FOREIGN  
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International Public Sector Accounting Standard 4, “The Effects of Changes in Foreign Exchange Rates” (IPSAS 4) is set out in paragraphs 1-73. All the paragraphs have equal authority. IPSAS 4 should be read in the context of its objective and the Basis for Conclusions, and the “Preface to the International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

- IN1. IPSAS 4, “The Effects of Changes in Foreign Exchange Rates,” replaces IPSAS 4, “The Effects of Changes in Foreign Exchange Rates” (issued December 2006), and should be applied for annual reporting periods beginning on or after January 1, 2010. Earlier application is encouraged.

### Reasons for Revising IPSAS 4

- IN2. The IPSASB developed this revised IPSAS 4 as a response to the IASB’s amendment to IAS 21 (published as *Net Investment in a Foreign Operation*) in December 2005 and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.
- IN3. In developing this revised IPSAS 4, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 21, “The Effects of Changes in Foreign Exchange Rates” made as a consequence of the IASB’s amendment in December 2005, except where the original IPSAS had varied from the provisions of IAS 21 for a public sector specific reason; such variances are retained in this IPSAS 4 and are noted in the Comparison with IAS 21.

### Changes from Previous Requirements

- IN4. The main changes from the previous version of IPSAS 4 are described below.

### Net Investment in a Foreign Operation

- IN5. The Standard clarifies that an entity that has a monetary item, which is, in substance, a part of the entity’s net investment in a foreign operation, and therefore accounts for such item in accordance with the requirements of this Standard, may be any controlled entity of the economic entity.

### Recognition of Exchange Differences

- IN6. The Standard requires that when a monetary item forms part of a reporting entity’s net investment in a foreign operation and is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, exchange differences arising on this monetary item are recognized initially in a separate component of net assets/equity in the financial statements that include the foreign operation and the reporting entity. Previously, such exchange differences were required to be recognized in surplus or deficit in the financial statements including the foreign operation and the reporting entity.

## IPSAS 4—THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

### Objective

1. An entity may carry on foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. The objective of this Standard is to prescribe how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a presentation currency.
2. The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

### Scope

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard:**
  - (a) **In accounting for transactions and balances in foreign currencies, except for those derivative transactions and balances that are within the scope of the relevant international or national accounting standards dealing with the recognition and measurement of financial instruments;**
  - (b) **In translating the financial performance and financial position of foreign operations that are included in the financial statements of the entity by consolidation, proportionate consolidation or by the equity method; and**
  - (c) **In translating an entity's financial performance and financial position into a presentation currency.**
4. International or national accounting standards dealing with the recognition and measurement of financial instruments apply to many foreign currency derivatives and, accordingly, these are excluded from the scope of this Standard. However, those foreign currency derivatives that are not within the scope of these international or national accounting standards (e.g., some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, this Standard applies when an entity translates amounts relating to derivatives from its functional currency to its presentation currency.
5. This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. Accordingly, entities may apply the relevant international or national accounting standards dealing with hedge accounting.

6. **This Standard applies to all public sector entities other than Government Business Enterprises.**
7. The “Preface to International Public Sector Accounting Standards” issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”
8. This Standard applies to the presentation of an entity’s financial statements in a foreign currency and sets out requirements for the resulting financial statements to be described as complying with IPSASs. For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.
9. This Standard does not apply to the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency, or to the translation of cash flows of a foreign operation (see IPSAS 2, “Cash Flow Statements”).

## Definitions

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

**Closing rate is the spot exchange rate at the reporting date.**

**Exchange difference is the difference resulting from translating a given number of units of one currency into another currency at different exchange rates.**

**Exchange rate is the ratio of exchange for two currencies.**

**Foreign currency is a currency other than the functional currency of the entity.**

**Foreign operation is an entity that is a controlled entity, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.**

**Functional currency is the currency of the primary economic environment in which the entity operates.**

**Monetary items are units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.**

**Net investment in a foreign operation is the amount of the reporting entity’s interest in the net assets/equity of that operation.**

**Presentation currency is the currency in which the financial statements are presented.**

**Spot exchange rate is the exchange rate for immediate delivery.**

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

### **Functional Currency**

11. The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. An entity considers the following factors in determining its functional currency:
  - (a) The currency:
    - (i) That revenue is raised from, such as taxes, grants, and fines;
    - (ii) That mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and
    - (iii) Of the country whose competitive forces and regulations mainly determine the sale prices of its goods and services.
  - (b) The currency that mainly influences labor, material and other costs of providing goods and services (this will often be the currency in which such costs are denominated and settled).
12. The following factors may also provide evidence of an entity's functional currency:
  - (a) The currency in which funds from financing activities (i.e., issuing debt and equity instruments) are generated.
  - (b) The currency in which receipts from operating activities are usually retained.
13. The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its controlled entity, branch, associate or joint venture):
  - (a) Whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when a department of defense has a number of overseas bases which conduct activities on behalf of a national government. The defense bases might conduct their activities substantially in the functional currency of the reporting entity. For example, military personnel may be paid in the functional currency and receive only a small allowance in local currency. Purchases of supplies and equipment might be largely

obtained via the reporting entity with purchases in local currency being kept to a minimum. Another example would be an overseas campus of a public university which operates under the management and direction of the domestic campus. In contrast, a foreign operation with a significant degree of autonomy may accumulate cash and other monetary items, incur expenses, generate revenue and perhaps arrange borrowings, all substantially in its local currency. Some examples of government-owned foreign operations which may operate independently of other government agencies include tourist offices, petroleum exploration companies, trade boards and broadcasting operations. Such entities may be established as GBEs.

- (b) Whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.
  - (c) Whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.
  - (d) Whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.
14. When the above indicators are mixed and the functional currency is not obvious, management uses its judgment to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and conditions. As part of this approach, management gives priority to the primary indicators in paragraph 11 before considering the indicators in paragraphs 12 and 13, which are designed to provide additional supporting evidence to determine an entity's functional currency.
15. An entity's functional currency reflects the underlying transactions, events and conditions that are relevant to it. Accordingly, once determined, the functional currency is not changed unless there is a change in those underlying transactions, events and conditions.
16. If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated in accordance with IPSAS 10, "Financial Reporting in Hyperinflationary Economies." An entity cannot avoid restatement in accordance with IPSAS 10 by, for example, adopting as its functional currency a currency other than the functional currency determined in accordance with this Standard (such as the functional currency of its controlling entity).

#### **Monetary Items**

17. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples

include: social policy obligations and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends or similar distributions that are recognized as a liability. Conversely, the essential feature of a nonmonetary item is the absence of a right to receive (or an obligation to deliver) a fixed or determinable number of units of currency. Examples include: amounts prepaid for goods and services (e.g., prepaid rent); goodwill; intangible assets; inventories; property, plant and equipment; and provisions that are to be settled by the delivery of a nonmonetary asset.

### **Net Investment in a Foreign Operation**

18. An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraphs 37 and 38. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.
19. The entity that has a monetary item receivable from or payable to a foreign operation described in paragraph 18 may be any controlled entity of the economic entity. For example, an entity has two controlled entities, A and B. Controlled entity B is a foreign operation. Controlled entity A grants a loan to controlled entity B. Controlled entity A's loan receivable from controlled entity B would be part of the controlled entity A's net investment in controlled entity B if settlement of the loan is neither planned nor likely to occur in the foreseeable future. This would also be true if controlled entity A were itself a foreign operation.

### **Summary of the Approach Required by This Standard**

20. In preparing financial statements, each entity – whether a standalone entity, an entity with foreign operations (such as a controlling entity) or a foreign operation (such as a controlled entity or branch) – determines its functional currency in accordance with paragraphs 11–16. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 23–42 and 59.
21. Many reporting entities comprise a number of individual entities (e.g., an economic entity is made up of a controlling entity and one or more controlled entities). Various types of entities, whether members of an economic entity or otherwise, may have investments in associates or joint ventures. They may also have branches. It is necessary for the financial performance and financial position of each individual entity included in the reporting entity to be translated into the currency in which the reporting entity presents its financial statements. This Standard permits the presentation currency of a reporting entity to be any currency (or currencies). The financial performance and financial position of any individual entity within the reporting entity whose

functional currency differs from the presentation currency are translated in accordance with paragraphs 43–59.

22. This Standard also permits a standalone entity preparing financial statements or an entity preparing separate financial statements in accordance with IPSAS 6, “Consolidated and Separate Financial Statements” to present its financial statements in any currency (or currencies). If the entity’s presentation currency differs from its functional currency, its financial performance and financial position are also translated into the presentation currency in accordance with paragraphs 43–59.

## **Reporting Foreign Currency Transactions in the Functional Currency**

### **Initial Recognition**

23. A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:
  - (a) Buys or sells goods or services whose price is denominated in a foreign currency;
  - (b) Borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or
  - (c) Otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.
24. **A foreign currency transaction shall be recorded, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.**
25. The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with IPSASs. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
26. Exchange rate changes may have an impact on cash or cash equivalents held or due in a foreign currency. The presentation of such exchange differences is dealt with in IPSAS 2. Although these changes are not cash flows, the effect of exchange rate changes on cash or cash equivalents held or due in a foreign currency are reported in the cash flow statement in order to reconcile cash and cash equivalents at the beginning and the end of the period. These amounts are presented separately from cash flows from operating, investing and

financing activities and include the differences, if any, had those cash flows been reported at end-of-period exchange rates.

### Reporting at Subsequent Reporting Dates

#### 27. At each reporting date:

- (a) **Foreign currency monetary items shall be translated using the closing rate;**
- (b) **Nonmonetary items that are measured in terms of historical cost in a foreign currency shall be translated using the exchange rate at the date of the transaction; and**
- (c) **Nonmonetary items that are measured at fair value in a foreign currency shall be translated using the exchange rates at the date when the fair value was determined.**

28. The carrying amount of an item is determined in conjunction with other relevant IPSASs. For example, property, plant and equipment may be measured in terms of fair value or historical cost in accordance with IPSAS 17, "Property, Plant and Equipment." Whether the carrying amount is determined on the basis of historical cost or on the basis of fair value, if the amount is determined in a foreign currency it is then translated into the functional currency in accordance with this Standard.

29. The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories held for sale is the lower of cost and net realizable value in accordance with IPSAS 12, "Inventories." Similarly, in accordance with IPSAS 21, "Impairment of Non-Cash-Generating Assets," the carrying amount of a non-cash generating asset for which there is an indication of impairment is the lower of its carrying amount before considering possible impairment losses and its recoverable service amount. When such an asset is nonmonetary and is measured in a foreign currency, the carrying amount is determined by comparing:

- (a) The cost or carrying amount, as appropriate, translated at the exchange rate at the date when that amount was determined (i.e., the rate at the date of the transaction for an item measured in terms of historical cost); and
- (b) The net realizable value or recoverable service amount, as appropriate, translated at the exchange rate at the date when that value was determined (e.g., the closing rate at the reporting date).

The effect of this comparison may be that an impairment loss is recognized in the functional currency but would not be recognized in the foreign currency, or vice versa.

30. When several exchange rates are available, the rate used is that at which the future cash flows represented by the transaction or balance could have been

settled if those cash flows had occurred at the measurement date. If exchangeability between two currencies is temporarily lacking, the rate used is the first subsequent rate at which exchanges could be made.

#### Recognition of Exchange Differences

31. As noted in paragraph 5, this Standard does not deal with hedge accounting for foreign currency items. Guidance in relation to hedge accounting, including the criteria for when to use hedge accounting, can be found in the relevant international or national accounting standards dealing with the recognition and measurement of financial instruments.
32. **Exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements shall be recognized in surplus or deficit in the period in which they arise, except as described in paragraph 37.**
33. When monetary items arise from a foreign currency transaction and there is a change in the exchange rate between the transaction date and the date of settlement, an exchange difference results. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognized in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognized in each period up to the date of settlement is determined by the change in exchange rates during each period.
34. The treatment of foreign currency exchange rate changes in a cash flow statement is described in paragraph 26.
35. **When a gain or loss on a nonmonetary item is recognized directly in net assets/equity, any exchange component of that gain or loss shall be recognized directly in net assets/equity. Conversely, when a gain or loss on a nonmonetary item is recognized in surplus or deficit, any exchange component of that gain or loss shall be recognized in surplus or deficit.**
36. Other Standards require some gains and losses to be recognized directly in net assets/equity. For example, IPSAS 17 requires some gains and losses arising on a revaluation of property, plant and equipment to be recognized directly in net assets/equity. When such an asset is measured in a foreign currency, paragraph 27 (c) of this Standard requires the revalued amount to be translated using the rate at the date the value is determined, resulting in an exchange difference that is also recognized in net assets/equity.
37. **Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (see paragraph 18) shall be recognized in surplus or deficit in the separate financial statements of the reporting entity or the individual financial**

**statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (e.g., consolidated financial statements when the foreign operation is a controlled entity), such exchange differences shall be recognized initially in a separate component of net assets/equity and recognized in surplus or deficit on disposal of the net investment in accordance with paragraph 57.**

38. When a monetary item forms part of a reporting entity's net investment in a foreign operation and is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's individual financial statements in accordance with paragraph 32. If such an item is denominated in the functional currency of the foreign operation, an exchange difference arises in the reporting entity's separate financial statements in accordance with paragraph 32. If such an item is denominated in a currency other than the functional currency of either the reporting entity or the foreign operation, an exchange difference arises in the reporting entity's separate financial statements and in the foreign operation's individual financial statements in accordance with paragraph 32. Such exchange differences are reclassified to the separate component of net assets/equity in the financial statements that include the foreign operation and the reporting entity (i.e., financial statements in which the foreign operation is consolidated, proportionately consolidated or accounted for using the equity method).
39. When an entity keeps its books and records in a currency other than its functional currency, at the time the entity prepares its financial statements all amounts are translated into the functional currency in accordance with paragraphs 23–30. This produces the same amounts in the functional currency as would have occurred had the items been recorded initially in the functional currency. For example, monetary items are translated into the functional currency using the closing rate, and nonmonetary items that are measured on a historical cost basis are translated using the exchange rate at the date of the transaction that resulted in their recognition.

#### **Change in Functional Currency**

40. **When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.**
41. As noted in paragraph 15, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices or the provision of goods and services may lead to a change in an entity's functional currency.

42. The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for nonmonetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously classified in net assets/equity in accordance with paragraphs 37 and 44(c) are not recognized in surplus or deficit until the disposal of the operation.

## **Use of a Presentation Currency Other than the Functional Currency**

### **Translation to the Presentation Currency**

43. An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, it translates its financial performance and financial position into the presentation currency. For example, when an economic entity, such as an international organization contains individual entities with different functional currencies, the financial performance and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented. For national, state/provincial, or governments, the presentation currency is normally determined by the ministry of finance (or similar authority) or established in legislation.
44. **The financial performance and financial position of an entity whose functional currency is not the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**
- (a) **Assets and liabilities for each statement of financial position presented (i.e., including comparatives) shall be translated at the closing rate at the date of that statement of financial position;**
  - (b) **Revenue and expenses for each statement of financial performance (i.e., including comparatives) shall be translated at exchange rates at the dates of the transactions; and**
  - (c) **All resulting exchange differences shall be recognized as a separate component of net assets/equity.**
45. In translating the cash flows, that is the cash receipts and cash payments, of a foreign operation for incorporation into its cash flow statement, the reporting entity shall comply with the procedures in IPSAS 2. IPSAS 2 requires that the cash flows of a controlled entity which satisfies the definition of a foreign operation shall be translated at the exchange rates between the presentation currency and the foreign currency at the dates of the cash flows. IPSAS 2 also outlines the presentation of unrealized gains and losses arising from changes

in foreign currency exchange rates on cash and cash equivalents held or due in a foreign currency.

46. For practical reasons, a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate revenue and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.
47. The exchange differences referred to in paragraph 44 (c) result from:
- (a) Translating revenue and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences arise both on revenue and expense items recognized in surplus or deficit and on those recognized directly in net assets/equity.
  - (b) Translating the opening net assets/equity at a closing rate that differs from the previous closing rate.

These exchange differences are not recognized in surplus or deficit because the changes in exchange rates have little or no direct effect on the present and future cash flows from operations. When the exchange differences relate to a foreign operation that is consolidated but is not wholly owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and recognized as part of, minority interest in the consolidated statement of financial position.

48. **The financial performance and financial position of an entity whose functional currency is the currency of a hyperinflationary economy shall be translated into a different presentation currency using the following procedures:**
- (a) **All amounts (i.e., assets, liabilities, net assets/equity items, revenue and expenses, including comparatives) shall be translated at the closing rate at the date of the most recent statement of financial position, except that**
  - (b) **When amounts are translated into the currency of a nonhyperinflationary economy, comparative amounts shall be those that were presented as current year amounts in the relevant prior year financial statements (i.e., not adjusted for subsequent changes in the price level or subsequent changes in exchange rates).**
49. **When an entity's functional currency is the currency of a hyperinflationary economy, the entity shall restate its financial statements in accordance with IPSAS 10 before applying the translation method set out in paragraph 48, except for comparative amounts that are translated into a currency of a non-hyperinflationary economy (see paragraph 48(b)). When the economy ceases to be hyperinflationary and**

**the entity no longer restates its financial statements in accordance with IPSAS 10, it shall use as the historical costs for translation into the presentation currency the amounts restated to the price level at the date the entity ceased restating its financial statements.**

#### **Translation of a Foreign Operation**

50. Paragraphs 51–56, in addition to paragraphs 43–49, apply when the financial performance and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation, proportionate consolidation or the equity method.
51. The incorporation of the financial performance and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of balances and transactions within an economic entity (see IPSAS 6 and IPSAS 8, “Interests in Joint Ventures”).
52. However, a monetary asset (or liability) within an economic entity, whether short-term or long-term, cannot be eliminated against the corresponding liability (or asset) within an economic entity without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference continues to be recognized in surplus or deficit or, if it arises from the circumstances described in paragraph 37, it is classified as net assets/equity until the disposal of the foreign operation.
53. When the financial statements of a foreign operation are as of a date different from that of the reporting entity, the foreign operation often prepares additional statements as of the same date as the reporting entity’s financial statements. When this is not done, IPSAS 6 allows the use of a different reporting date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different dates.
54. When there is a difference between the reporting date of the reporting entity and the foreign operation, the assets and liabilities of the foreign operation are translated at the exchange rate at the reporting date of the foreign operation.
55. Adjustments are made for significant changes in exchange rates up to the reporting date of the reporting entity in accordance with IPSAS 6. The same approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation to joint ventures in accordance with IPSAS 7, “Investments in Associates” and IPSAS 8.

56. **Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the carrying amounts of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraphs 44 and 48.**

#### **Disposal of a Foreign Operation**

57. **On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of net assets/equity relating to that foreign operation shall be recognized in surplus or deficit when the gain or loss on disposal is recognized.**
58. An entity may dispose of its interest in a foreign operation through sale, liquidation, repayment of contributed capital or abandonment of all, or part of, that entity. The payment of a dividend or similar distribution is part of a disposal only when it constitutes a return of the investment, for example when the dividend or similar distribution is paid out of preacquisition surplus. In the case of a partial disposal, only the proportionate share of the related accumulated exchange difference is included in the gain or loss. A write-down of the carrying amount of a foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognized in surplus or deficit at the time of a write-down.

#### **Tax Effects of Exchange Differences**

59. For reporting entities subject to income taxes, guidance on the treatment of tax effects associated with the gains and losses on foreign currency transactions and exchange differences arising on translating the financial performance and financial position of an entity (including a foreign operation) into a different currency can be found in the relevant international or national accounting standards dealing with income taxes.

#### **Disclosure**

60. **In paragraphs 62 and 64–66 references to “functional currency” apply, in the case of an economic entity, to the functional currency of the controlling entity.**
61. **The entity shall disclose:**
- (a) **The amount of exchange differences recognized in surplus or deficit except for those arising on financial instruments measured at fair value through surplus or deficit in accordance with the relevant international or national accounting standards dealing with the recognition and measurement of financial instruments; and**

- (b) **Net exchange differences classified in a separate component of net assets/equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.**
62. **When the presentation currency is different from the functional currency, that fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.**
63. **When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact and the reason for the change in functional currency shall be disclosed.**
64. **When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with International Public Sector Accounting Standards only if they comply with all the requirements of each applicable Standard including the translation method set out in paragraphs 44 and 48.**
65. An entity sometimes presents its financial statements or other financial information in a currency that is not its functional currency without meeting the requirements of paragraph 64. For example, an entity may convert into another currency only selected items from its financial statements. Or, an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with International Public Sector Accounting Standards and the disclosures set out in paragraph 66 are required.
66. **When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency and the requirements of paragraph 64 are not met, it shall:**
- (a) **Clearly identify the information as supplementary information to distinguish it from the information that complies with International Public Sector Accounting Standards;**
  - (b) **Disclose the currency in which the supplementary information is displayed; and**
  - (c) **Disclose the entity's functional currency and the method of translation used to determine the supplementary information.**

## **Transitional Provisions**

### **First-time Adoption of Accrual Accounting**

67. **A reporting entity need not comply with the requirements for cumulative translation differences that existed at the date of first adoption of accrual accounting in accordance with IPSASs. If a first-time adopter uses this exemption:**
- (a) **The cumulative translation differences for all foreign operations are deemed to be zero at the date of first adoption to IPSASs; and**
  - (b) **The gain and loss on a subsequent disposal of any foreign operation shall exclude translation differences that arose before the date of first adoption to IPSASs, and shall include later translation differences.**
68. This Standard requires entities to:
- (a) Classify some translation differences as a separate component of net assets/equity; and
  - (b) On disposal of a foreign operation, to transfer the cumulative translation difference for that foreign operation to the statement of financial performance as part of the gain or loss on disposal.

The transitional provisions provide first-time adopters of IPSASs with relief from this requirement.

### **Transitional Provisions for All Entities**

69. **An entity shall apply paragraph 56 prospectively to all acquisitions occurring after the beginning of the financial reporting period in which this IPSAS is first applied. Retrospective application of paragraph 56 to earlier acquisitions is permitted. For an acquisition of a foreign operation treated prospectively but which occurred before the date on which this Standard is first applied, the entity shall not restate prior years and accordingly may, when appropriate, treat goodwill and fair value adjustments arising on that acquisition as assets and liabilities of the entity rather than as assets and liabilities of the foreign operation. Therefore, those goodwill and fair value adjustments either are already expressed in the entity's functional currency or are nonmonetary foreign currency items, which are reported using the exchange rate at the date of the acquisition.**
70. **All other changes resulting from the application of this IPSAS shall be accounted for in accordance with the requirements of IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors."**

**Effective Date**

71. **An entity shall apply this IPSAS for annual periods beginning on or after January 1, 2010. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2010, it shall disclose that fact.**
72. When an entity adopts the accrual basis of accounting, as defined by IPSASs, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

**Withdrawal of IPSAS 4 (issued 2006)**

73. This Standard supersedes IPSAS 4, "The Effects of Changes in Foreign Exchange Rates" issued in 2006.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, IPSAS 4, “The Effects of Changes in Foreign Exchange Rates.” This Basis for Conclusions only notes the IPSASB’s reasons for departing from provisions of the related International Accounting Standard.*

### Background

- BC1. The IPSASB’s IFRS Convergence Program is an important element in IPSASB’s work program. The IPSASB’s strategy is to converge the accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the ‘comparison with IFRS’ included in each IPSAS. The Comparison with IAS 21 references only the version of IAS 21 that was revised in 2003 and amended in 2005.<sup>1</sup>
- BC3. In May 2000 the IPSASB’s predecessor, the Public Sector Committee (PSC)<sup>2</sup>, issued the first version of IPSAS 4, “The Effects of Changes in Foreign Exchange Rates,” which was based on IAS 21, “The Effects of Changes in Foreign Exchange Rates” (1993). In December 2006 the IPSASB revised IPSAS 4, which was based on IAS 21 (Revised 2003), as part of its General Improvements Project. In December 2005 the IASB issued an amendment to IAS 21 (published as “Net Investment in a Foreign Operation”).
- BC4. In early 2007, the IPSASB initiated a continuous improvements project to update existing IPSASs to be converged with the latest related IFRSs to the extent appropriate for the public sector. As part of the project, the IPSASB reviewed the IASB’s amendment to IAS 21 issued in December 2005 and generally concurred with the IASB’s reasons for amending the IAS and with the amendment made. (The IASB’s Basis for Conclusions as a result of the amendment is not reproduced here. Subscribers to the IASB’s *Comprehensive*

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<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB’s predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC’s mandate to become an independent standard-setting board in November 2004.

*Subscription Service* can view the Basis for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)).

- BC5. IAS 21 has been further amended as a consequence of IFRSs and revised IASs issued after December 2005. IPSAS 4 does not include the consequential amendments arising from IFRSs or revised IASs issued after December 2005. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs and the revisions to those IASs to public sector entities.

**TABLE OF CONCORDANCE**

This table shows how the contents of the superseded version of IPSAS 4 and the current version of IPSAS 4 correspond. Paragraphs are treated as corresponding if they broadly address the same matter even though the guidance may differ.

<b>Superseded IPSAS 4 paragraphs</b>	<b>Current IPSAS 4 paragraph</b>	<b>Superseded IPSAS 4 paragraphs</b>	<b>Current IPSAS 4 paragraph</b>	<b>Superseded IPSAS 4 paragraphs</b>	<b>Current IPSAS 4 paragraph</b>
1	1	26	27	51	52
2	2	27	28	52	53
3	3	28	29	53	54
4	4	29	30	54	55
5	5	30	31	55	56
6	6	31	32	56	57
7	7	32	33	57	58
8	8	33	34	58	59
9	9	34	35	59	60
10	10	35	36	60	61
11	11	36	37	61	62
12	12	37	38	62	63
13	13	38	39	63	64
14	14	39	40	64	65
15	15	40	41	65	66
16	16	41	42	66	67
17	17	42	43	67	68
18	18	43	44	68	69
19	20	44	45	69	70
20	21	45	46	70	71
21	22	46	47	71	72
22	23	47	48	72	73
23	24	48	49	None	19
24	25	49	50		
25	26	50	51		

### Comparison with IAS 21

IPSAS 4, “The Effects of Changes in Foreign Exchange Rates” is drawn primarily from IAS 21, “The Effects of Changes in Foreign Exchange Rates” (revised in 2003, as amended in 2005). The main differences between IPSAS 4 and IAS 21 are as follows:

- Commentary additional to that in IAS 21 has been included in paragraphs 1, 11, 13, 26, 43, 45, 67, 68, 72 of IPSAS 4 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 4 contains an additional transitional provision allowing an entity, when first adopting IPSASs, to deem cumulative translation differences existing at the date of first adoption of accrual IPSASs as zero (paragraph 67). This transitional provision is adapted from IFRS 1, “First-time Adoption of International Financial Reporting Standards.”
- IPSAS 4 uses different terminology, in certain instances, from IAS 21. The most significant examples are the use of the terms revenue, economic entity, statement of financial performance and net assets/equity in IPSAS 4. The equivalent terms in IAS 21 are income, group, statement of comprehensive income and equity.

## **IPSAS 5—BORROWING COSTS**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 23, “Borrowing Costs” published by the International Accounting Standards Board (IASB). Extracts from IAS 23 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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*The standards, which have been set in bold, should be read in the context of the commentary paragraphs in this Standard which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.*

## **Objective**

This Standard prescribes the accounting treatment for borrowing costs. This Standard generally requires the immediate expensing of borrowing costs. However, the Standard permits, as an allowed alternative treatment, the capitalization of borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset.

## **Scope**

1. **This Standard should be applied in accounting for borrowing costs.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. The “Preface to International Public Sector Accounting Standards” issued by the IPSASB explains that GBEs apply IFRSs which are issued by the IASB. GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”
4. This Standard does not deal with the actual or imputed cost of net assets/equity. Where jurisdictions apply a capital charge to individual entities, judgment will need to be exercised to determine whether the charge meets the definition of borrowing costs or whether it should be treated as an actual or imputed cost of net assets/equity.

## **Definitions**

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

**Accrual basis** means a basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.

**Assets** are resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

**Borrowing costs** are interest and other expenses incurred by an entity in connection with the borrowing of funds.

**Cash** comprises cash on hand and demand deposits.

**Contributions from owners** means future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:

- (a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or
- (b) Can be sold, exchanged, transferred or redeemed.

**Distributions to owners** means future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.

**Economic entity** means a group of entities comprising a controlling entity and one or more controlled entities.

**Expenses** are decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.

**Government Business Enterprise** means an entity that has all the following characteristics:

- (a) Is an entity with the power to contract in its own name;
- (b) Has been assigned the financial and operational authority to carry on a business;
- (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;
- (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and
- (e) Is controlled by a public sector entity.

**Liabilities** are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

**Net assets/equity** is the residual interest in the assets of the entity after deducting all its liabilities.

**Qualifying asset** is an asset that necessarily takes a substantial period of time to get ready for its intended use or sale.

**Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.**

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

### **Borrowing Costs**

6. Borrowing costs may include:
  - (a) Interest on bank overdrafts and short-term and long-term borrowings;
  - (b) Amortization of discounts or premiums relating to borrowings;
  - (c) Amortization of ancillary costs incurred in connection with the arrangement of borrowings;
  - (d) Finance charges in respect of finance leases; and
  - (e) Exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

### **Economic Entity**

7. The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.
8. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity and group.
9. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

### **Future Economic Benefits or Service Potential**

10. Assets provide a means for entities to achieve their objectives. Assets that are used to deliver goods and services in accordance with an entity's objectives but which do not directly generate net cash inflows are often described as embodying service potential. Assets that are used to generate net cash inflows are often described as embodying "future economic benefits." To encompass all the purposes to which assets may be put, this

Standard uses the term “future economic benefits or service potential” to describe the essential characteristic of assets.

### **Government Business Enterprises**

11. Government Business Enterprises (GBEs) include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge. IPSAS 6, “Consolidated and Separate Financial Statements” provides guidance on determining whether control exists for financial reporting purposes, and should be referred to in determining whether a GBE is controlled by another public sector entity.

### **Net Assets/Equity**

12. Net assets/equity is the term used in this Standard to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

### **Qualifying Assets**

13. Examples of qualifying assets are office buildings, hospitals, infrastructure assets such as roads, bridges and power generation facilities, and inventories that require a substantial period of time to bring them to a condition ready for use or sale. Other investments, and those assets that are routinely produced over a short period of time, are not qualifying assets. Assets that are ready for their intended use or sale when acquired also are not qualifying assets.

## **Borrowing Costs—Benchmark Treatment**

### **Recognition**

14. **Borrowing costs should be recognized as an expense in the period in which they are incurred.**
15. Under the benchmark treatment, borrowing costs are recognized as an expense in the period in which they are incurred, regardless of how the borrowings are applied.

### **Disclosure**

16. **The financial statements should disclose the accounting policy adopted for borrowing costs.**

## Borrowing Costs—Allowed Alternative Treatment

### Recognition

17. **Borrowing costs should be recognized as an expense in the period in which they are incurred, except to the extent that they are capitalized in accordance with paragraph 18.**
18. **Borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset should be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization should be determined in accordance with this Standard.**
19. Under the allowed alternative treatment, borrowing costs that are directly attributable to the acquisition, construction or production of an asset are included in the cost of that asset. Such borrowing costs are capitalized as part of the cost of the asset when it is probable that they will result in future economic benefits or service potential to the entity and the costs can be measured reliably. Other borrowing costs are recognized as an expense in the period in which they are incurred.
20. **Where an entity adopts the allowed alternative treatment, that treatment should be applied consistently to all borrowing costs that are directly attributable to the acquisition, construction or production of all qualifying assets of the entity.**

### Borrowing Costs Eligible for Capitalization

21. The borrowing costs that are directly attributable to the acquisition, construction or production of a qualifying asset are those borrowing costs that would have been avoided if the outlays on the qualifying asset had not been made. When an entity borrows funds specifically for the purpose of obtaining a particular qualifying asset, the borrowing costs that directly relate to that qualifying asset can be readily identified.
22. It may be difficult to identify a direct relationship between particular borrowings and a qualifying asset and to determine the borrowings that could otherwise have been avoided. Such a difficulty occurs, for example, when the financing activity of an entity is co-ordinated centrally. Difficulties also arise when an economic entity uses a range of debt instruments to borrow funds at varying rates of interest, and transfers those funds on various bases to other entities in the economic entity. Funds which have been borrowed centrally may be transferred to other entities within the economic entity as a loan, a grant or a capital injection. Such transfers may be interest-free or require that only a portion of the actual interest cost be recovered. Other complications arise through the use of loans denominated in or linked to foreign currencies, when the economic entity operates in highly inflationary economies, and from fluctuations in exchange rates. As

a result, the determination of the amount of borrowing costs that are directly attributable to the acquisition of a qualifying asset is difficult and the exercise of judgment is required.

23. **To the extent that funds are borrowed specifically for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization on that asset should be determined as the actual borrowing costs incurred on that borrowing during the period less any investment income on the temporary investment of those borrowings.**
24. The financing arrangements for a qualifying asset may result in an entity obtaining borrowed funds and incurring associated borrowing costs before some or all of the funds are used for outlays on the qualifying asset. In such circumstances, the funds are often temporarily invested pending their outlay on the qualifying asset. In determining the amount of borrowing costs eligible for capitalization during a period, any investment income earned on such funds is deducted from the borrowing costs incurred.
25. **To the extent that funds are borrowed generally and used for the purpose of obtaining a qualifying asset, the amount of borrowing costs eligible for capitalization should be determined by applying a capitalization rate to the outlays on that asset. The capitalization rate should be the weighted average of the borrowing costs applicable to the borrowings of the entity that are outstanding during the period, other than borrowings made specifically for the purpose of obtaining a qualifying asset. The amount of borrowing costs capitalized during a period should not exceed the amount of borrowing costs incurred during that period.**
26. Only those borrowing costs applicable to the borrowings of the entity may be capitalized. When a controlling entity borrows funds which are passed on to a controlled entity with no, or only partial, allocation of borrowing costs, the controlled entity may capitalize only those borrowing costs which it itself has incurred. Where a controlled entity receives an interest-free capital contribution or capital grant, it will not incur any borrowing costs and consequently will not capitalize any such costs.
27. When a controlling entity transfers funds at partial cost to a controlled entity, the controlled entity may capitalize that portion of borrowing costs which it itself has incurred. In the financial statements of the economic entity, the full amount of borrowing costs can be capitalized to the qualifying asset, provided that appropriate consolidation adjustments have been made to eliminate those costs capitalized by the controlled entity.
28. When a controlling entity has transferred funds at no cost to a controlled entity, neither the controlling entity nor the controlled entity would meet the criteria for capitalization of borrowing costs. However, if the economic entity met the criteria for capitalization of borrowing costs, it would be able

to capitalize the borrowing costs to the qualifying asset in its financial statements.

29. In some circumstances, it is appropriate to include all borrowings of the controlling entity and its controlled entities when computing a weighted average of the borrowing costs; in other circumstances, it is appropriate for each controlled entity to use a weighted average of the borrowing costs applicable to its own borrowings.

#### **Excess of the Carrying Amount of the Qualifying Asset over Recoverable Amount**

30. When the carrying amount or the expected ultimate cost of the qualifying asset exceeds its recoverable amount or net realizable value, the carrying amount is written down or written off in accordance with the requirements of other international and/or national accounting standards. In certain circumstances, the amount of the write-down or write-off is written back in accordance with those other standards.

#### **Commencement of Capitalization**

31. **The capitalization of borrowing costs as part of the cost of a qualifying asset should commence when:**
- (a) **Outlays for the asset are being incurred;**
  - (b) **Borrowing costs are being incurred; and**
  - (c) **Activities that are necessary to prepare the asset for its intended use or sale are in progress.**
32. Outlays on a qualifying asset include only those outlays that have resulted in payments of cash, transfers of other assets or the assumption of interest-bearing liabilities. The average carrying amount of the asset during a period, including borrowing costs previously capitalized, is normally a reasonable approximation of the outlays to which the capitalization rate is applied in that period.
33. The activities necessary to prepare the asset for its intended use or sale encompass more than the physical construction of the asset. They include technical and administrative work prior to the commencement of physical construction, such as the activities associated with obtaining permits. However, such activities exclude the holding of an asset when no production or development that changes the asset's condition is taking place. For example, borrowing costs incurred while land is under development are capitalized during the period in which activities related to the development are being undertaken. However, borrowing costs incurred while land acquired for building purposes is held without any associated development activity do not qualify for capitalization.

### Suspension of Capitalization

34. **Capitalization of borrowing costs should be suspended during extended periods in which active development is interrupted, and expensed.**
35. Borrowing costs may be incurred during an extended period in which the activities necessary to prepare an asset for its intended use or sale are interrupted. Such costs are costs of holding partially completed assets and do not qualify for capitalization. However, capitalization of borrowing costs is not normally suspended during a period when substantial technical and administrative work is being carried out. Capitalization of borrowing costs is also not suspended when a temporary delay is a necessary part of the process of getting an asset ready for its intended use or sale. For example, capitalization continues during an extended period needed for inventories to mature or an extended period during which high water levels delay construction of a bridge, if such high water levels are common during the construction period in the geographic region involved.

### Cessation of Capitalization

36. **Capitalization of borrowing costs should cease when substantially all the activities necessary to prepare the qualifying asset for its intended use or sale are complete.**
37. An asset is normally ready for its intended use or sale when the physical construction of the asset is complete even though routine administrative work might still continue. If minor modifications, such as the decoration of a property to the purchaser's or user's specification, are all that is outstanding, this indicates that substantially all the activities are complete.
38. **When the construction of a qualifying asset is completed in parts and each part is capable of being used while construction continues on other parts, capitalization of borrowing costs should cease when substantially all the activities necessary to prepare that part for its intended use or sale are completed.**
39. An office development comprising several buildings, each of which can be used individually, is an example of a qualifying asset for which each part is capable of being used while construction continues on other parts. Examples of qualifying assets that need to be complete before any part can be used include an operating theatre in a hospital when all construction must be complete before the theatre may be used; a sewage treatment plant where several processes are carried out in sequence at different parts of the plant; and a bridge forming part of a highway.

**Disclosure**

40. **The financial statements should disclose:**
- (a) **The accounting policy adopted for borrowing costs;**
  - (b) **The amount of borrowing costs capitalized during the period; and**
  - (c) **The capitalization rate used to determine the amount of borrowing costs eligible for capitalization (when it was necessary to apply a capitalization rate to funds borrowed generally).**

**Transitional Provisions**

41. **When the adoption of this Standard constitutes a change in accounting policy, an entity is encouraged to adjust its financial statements in accordance with IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.” Alternatively, entities following the allowed alternative treatment should capitalize only those borrowing costs incurred after the effective date of this Standard which meet the criteria for capitalization.**

**Effective Date**

42. **This IPSAS becomes effective for annual financial statements covering periods beginning on or after July 1, 2001. Earlier application is encouraged.**
43. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity’s annual financial statements covering periods beginning on or after the date of adoption.

### Comparison with IAS 23

International Public Sector Accounting Standard (IPSAS) 5, “Borrowing Costs” is drawn primarily from International Accounting Standard (IAS) 23, “Borrowing Costs.” The main differences between IPSAS 5 and IAS 23 are as follows:

- Commentary additional to that in IAS 23 has been included in IPSAS 5 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 5 uses different terminology, in certain instances, from IAS 23. The most significant examples are the use of the terms entity, revenue, statement of financial performance, statement of financial position and net assets/equity in IPSAS 5. The equivalent terms in IAS 23 are enterprise, income, income statement, balance sheet and equity.
- IPSAS 5 contains a different set of definitions of technical terms from IAS 23 (paragraph 5).

## **IPSAS 6—CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 27 (Revised 2003), “Consolidated and Separate Financial Statements” published by the International Accounting Standards Board (IASB). Extracts from IAS 27 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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# IPSAS 6—CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

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International Public Sector Accounting Standard 6, “Consolidated and Separated Financial Statements” (IPSAS 6) is set out in paragraphs 1–71 and the Appendix. All the paragraphs have equal authority. IPSAS 6 should be read in the context of the Basis for Conclusion, and the “Preface to International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

IN1. IPSAS 6, “Consolidated and Separate Financial Statements,” replaces IPSAS 6, “Consolidated Financial Statements and Accounting for Controlled Entities” (issued May 2000), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## Reasons for Revising IPSAS 6

IN2. The IPSASB developed this revised IPSAS 6 as a response to the International Accounting Standards Board’s project on Improvements to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 6, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 27, “Consolidated Financial Statements and Accounting for Controlled Entities” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 27 for a public sector specific reason; such variances are retained in this IPSAS 6 and are noted in the Comparison with IAS 27. Any changes to IAS 27 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 1.

## Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 6 are described below.

## Scope

IN5. The Standard clarifies in paragraph 3 that it applies to accounting for controlled entities, jointly controlled entities and associates in the separate financial statements of a controlling entity, a venturer or an investor.

## Definitions

IN6. The Standard:

- Defines two new terms: cost method and separate financial statements.
- No longer includes the unnecessary definitions: accounting policies, accrual basis, assets, associates, cash, contributions from owners, distributions to owners, equity method, expenses, “government business enterprises, investor in a joint venture, joint control, joint venture, liabilities, net assets/equity, reporting date, revenue and significant influence.
- No longer includes the definition net surplus/deficit, which no longer exists. This definition has also been eliminated from IPSAS 1,

“Presentation of Financial Statements” and IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.”

IN7. Includes in paragraphs 8–11 further illustrations of the term separate financial statements. Previously, IPSAS 6 did not contain these illustrations.

### **Exemptions from Preparing Consolidated Financial Statements**

IN8. The Standard clarifies and tightens in paragraph 16 the circumstances in which a controlling entity is exempted from preparing consolidated financial statements. A controlling entity need not present consolidated financial statements if and only if:

- The controlling entity is itself a wholly-owned controlled entity and users of such financial statements are unlikely to exist or their information needs are met by its controlling entity’s consolidated financial statements; or the controlling entity is a partially-owned controlled entity of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the controlling entity not preparing consolidated financial statements;
- The controlling entity’s debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
- The controlling entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and
- The ultimate or any intermediate controlling entity of the controlling entity produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.

Previously, IPSAS 3 specified that a controlling entity that is a wholly owned controlled entity, or is a virtually wholly owned, need not present consolidated financial statements provided users of such financial statements are unlikely to exist or their information needs are met by the controlling entity’s consolidated financial statements; or, in the case of one that is virtually wholly owned, the controlling entity obtains the approval of the owners of the minority interest.

### **Exemptions from Consolidation**

IN9. The Standard clarifies in paragraph 21 that a controlled entity shall be excluded from consolidation when there is evidence that (a) control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its disposal within twelve months from acquisition

and (b) management is actively seeking a buyer. The Standard further specifies that when a controlled entity previously excluded from consolidation is not disposed of within twelve months, it must be consolidated as from the acquisition date unless narrowly specified circumstances apply.

The words “in the near future” used in previous IPSAS 6 were replaced with the words “within twelve months.” In addition, there was no similar requirement to (b) in previous IPSAS 6 for exclusion from consolidation.

- IN10. The Standard clarifies in paragraph 26 that the requirement to consolidate investments in controlled entities applies to venture capital organization, mutual funds, unit trusts and similar entities. Previously, IPSAS 6 did not contain this clarification.
- IN11. The Standard no longer provides the previous exemption from consolidating for an entity which operates under external long-term severe restrictions which prevents the controlling entity from benefiting from its activities (see previous paragraphs 22(b) and 25).

### **Consolidation Procedures**

- IN12. The Standard requires an entity to consider the existence and effect of potential voting rights currently exercisable or convertible when assessing whether it has the power to govern the financial and operating policies of another entity (see paragraphs 33, 34). Previously, IPSAS 6 did not contain these requirements.
- IN13. The Standard clarifies in paragraph 49 that an entity shall use uniform accounting policies for reporting like transactions and other events in similar circumstances. Previously, IPSAS 6 provided an exception to this requirement when it was “not practicable to use uniform accounting policies.”
- IN14. The Standard requires in paragraph 54 that minority interests shall be presented in the consolidated statement of financial position within net assets/equity, separately from the controlling entity’s net assets/equity. Previously, though IPSAS 6 precluded presentation of minority interests within liabilities, it did not require presentation within net assets/equity.

### **Separate Financial Statements**

- IN15. The Standard requires in paragraph 58 that investments in controlled entities, jointly controlled entities be accounted for using the equity method, at cost or as a financial instrument. Previously IPSAS 6 required entities to be accounted for using the equity method or as an investment.
- IN16. The Standard requires in paragraph 60 that controlled entities, jointly controlled entities and associates that are accounted for as financial instruments in the consolidated financial statements shall be accounted for in

the same way in the investor's separate financial statements. Previously, IPSAS 6 did not contain this requirement.

### **Disclosure**

IN17. The Standard requires additional disclosures in respect of separate financial statements (see paragraphs 63 and 64).

### **Amendments to Other IPSASs**

IN18. The Standard includes an authoritative appendix of amendments to other IPSASs that are not part of the IPSASs Improvements project and will be impacted as a result of the proposals in this IPSAS.

### **Implementation Guidance**

IN19. The Standard includes Implementation Guidance, which illustrates how to consider the impact of potential voting rights on an entity's power to govern the financial and operating policies of another entity when implementing IPSAS 6, IPSAS 7, "Investments in Associates" and IPSAS 8, "Interests in Joint Ventures."

## IPSAS 6—CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

### Scope

1. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the preparation and presentation of consolidated financial statements for an economic entity.**
2. This Standard does not deal with methods of accounting for entity combinations and their effects on consolidation, including goodwill arising on an entity combination (guidance on accounting for entity combinations can be found in the relevant international or national accounting standard dealing with business combinations).
3. **This Standard shall also be applied in accounting for controlled entities, jointly controlled entities and associates when an entity elects, or is required by local regulations, to present separate financial statements.**
4. **This Standard applies to all public sector entities other than Government Business Enterprises.**
5. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”
6. This Standard establishes requirements for the preparation and presentation of consolidated financial statements, and for accounting for controlled entities, jointly controlled entities and associates in the separate financial statements of the controlling entity, the venturer and the investor. Although GBEs are not required to comply with this Standard in their own financial statements, the provisions of this Standard will apply where a public sector entity that is not a GBE has one or more controlled entities, jointly controlled entities and associates that are GBEs. In these circumstances, this Standard shall be applied in consolidating GBEs into the financial statements of the economic entity, and in accounting for investments in GBEs in the controlling entity’s, the venturer’s and the investor’s separate financial statements.

### Definitions

7. **The following terms are used in this Standard with the meanings specified:**  
**Consolidated financial statements are the financial statements of an economic entity presented as those of a single entity.**

**Control** is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

**Controlled entity** is an entity, including an unincorporated entity such as a partnership, that is under the control of another entity (known as the controlling entity).

**Controlling entity** is an entity that has one or more controlled entities.

The **cost method** is a method of accounting for an investment whereby the investment is recognized at cost. The investor recognizes revenue from the investment only to the extent that the investor is entitled to receive distributions from accumulated surpluses of the investee arising after the date of acquisition. Entitlements due or received in excess of such surpluses are regarded as a recovery of investment and are recognized as a reduction of the cost of the investment.

**Economic entity** means a group of entities comprising a controlling entity and one or more controlled entities.

**Minority interest** is that portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly through controlled entities, by the controlling entity.

**Separate financial statements** are those presented by a controlling entity, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.

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

#### **Consolidated Financial Statements and Separate Financial Statements**

8. A controlling entity or its controlled entity may be an investor in an associate or a venturer in a jointly controlled entity. In such cases, consolidated financial statements prepared and presented in accordance with this Standard are also prepared so as to comply with IPSAS 7, "Investments in Associates" and IPSAS 8, "Interests in Joint Ventures."
9. For an entity described in paragraph 8, separate financial statements are those prepared and presented in addition to the financial statements referred to in paragraph 8. Separate financial statements need not be appended to, or accompany, those statements.

10. The financial statements of an entity that does not have a controlled entity, associate or venturer's interest in a jointly controlled entity are not separate financial statements.
11. A controlling entity that is exempted in accordance with paragraph 16 from presenting consolidated financial statements may present separate financial statements as its only financial statements.

### **Economic Entity**

12. The term economic entity is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.
13. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity, consolidated entity and group.
14. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

### **Presentation of Consolidated Financial Statements**

15. **A controlling entity, other than a controlling entity described in paragraph 16, shall present consolidated financial statements in which it consolidates its controlled entities in accordance with this Standard.**
16. **A controlling entity need not present consolidated financial statements if and only if:**
  - (a) **The controlling entity is:**
    - (i) **Itself a wholly-owned controlled entity and users of such financial statements are unlikely to exist or their information needs are met by its controlling entity's consolidated financial statements; or**
    - (ii) **A partially-owned controlled entity of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the controlling entity not presenting consolidated financial statements;**
  - (b) **The controlling entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);**
  - (c) **The controlling entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other**

**regulatory organization for the purpose of issuing any class of instruments in a public market; and**

- (d) **The ultimate or any intermediate controlling entity of the controlling entity produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.**
17. In the public sector many controlling entities that are either wholly owned or partially owned, represent key sectors or activities of a government and the purpose of this Standard is not to exempt such entities from preparing consolidated financial statements. In this situation, the information needs of certain users may not be served by the consolidated financial statements at a whole-of-government level alone. In many jurisdictions, governments have recognized this and have legislated the financial reporting requirements of such entities.
18. In some instances, an economic entity will include a number of intermediate controlling entities. For example, whilst a department of health may be the ultimate controlling entity, there may be intermediate controlling entities at the local or regional health authority level. Accountability and reporting requirements in each jurisdiction may specify which entities are required to (or exempted from the requirement to) prepare consolidated financial statements. Where there is no specific reporting requirement for an intermediate controlling entity to prepare consolidated financial statements for which users are likely to exist, intermediate controlling entities are to prepare and publish consolidated financial statements.
19. A controlling entity that elects in accordance with paragraph 16 not to present consolidated financial statements, and presents only separate financial statements, complies with paragraphs 58-64.

### **Scope of Consolidated Financial Statements**

20. **Consolidated financial statements shall include all controlled entities of the controlling entity, except those referred to in paragraph 21.**
21. **A controlled entity shall be excluded from consolidation when there is evidence that (a) control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its disposal within twelve months from acquisition and (b) management is actively seeking a buyer.**
22. Such controlled entities are classified and accounted for as financial instruments. The relevant international or national accounting standard dealing with the recognition and measurement of financial instruments provides guidance on classification and accounting for financial instruments.

23. An example of temporary control is where a controlled entity is acquired with a firm plan to dispose of it within twelve months. This may occur where an economic entity is acquired and an entity within it is to be disposed of because its activities are dissimilar to those of the acquirer. Temporary control also occurs where the controlling entity intends to cede control over a controlled entity to another entity—for example a national government may transfer its interest in a controlled entity to a local government. For this exemption to apply, the controlling entity must be demonstrably committed to a formal plan to dispose of, or no longer control, the entity that is subject to temporary control. An entity is demonstrably committed to dispose of, or no longer control, another entity when it has a formal plan to do so and there is no realistic possibility of withdrawal from that plan.
24. When a controlled entity previously excluded from consolidation in accordance with paragraph 21 is not disposed of within twelve months, it shall be consolidated as from the acquisition date (guidance on the acquisition date can be found in the relevant international or national accounting standard dealing with business combinations). Financial statements for the periods since acquisition are restated.
25. Exceptionally, an entity may have found a buyer for a controlled entity excluded from consolidation in accordance with paragraph 21, but may not have completed the sale within twelve months of acquisition because of the need for approval by regulators or others. The entity is not required to consolidate such a controlled entity if the sale is in process at the reporting date and there is no reason to believe that it will not be completed shortly after the reporting date.
26. A controlled entity is not excluded from consolidation simply because the investor is a venture capital organization, mutual fund, unit trust or similar entity.
27. A controlled entity is not excluded from consolidation because its activities are dissimilar to those of the other entities within the economic entity, for example, the consolidation of GBEs with entities in the budget sector. Relevant information is provided by consolidating such controlled entities and disclosing additional information in the consolidated financial statements about the different activities of controlled entities. For example, the disclosures required by IPSAS 18, “Segment Reporting” help to explain the significance of different activities within the economic entity.

#### **Establishing Control of Another Entity for Financial Reporting Purposes**

28. Whether an entity controls another entity for financial reporting purposes is a matter of judgment based on the definition of control in this Standard and the particular circumstances of each case. That is, consideration needs to be given to the nature of the relationship between the two entities. In particular, the two

elements of the definition of control in this Standard need to be considered. These are the power element (the power to govern the financial and operating policies of another entity) and the benefit element (which represents the ability of the controlling entity to benefit from the activities of the other entity).

29. For the purposes of establishing control, the controlling entity needs to benefit from the activities of the other entity. For example, an entity may benefit from the activities of another entity in terms of a distribution of its surpluses (such as a dividend) and is exposed to the risk of a potential loss. In other cases, an entity may not obtain any financial benefits from the other entity but may benefit from its ability to direct the other entity to work with it to achieve its objectives. It may also be possible for an entity to derive both financial and non-financial benefits from the activities of another entity. For example, a GBE may provide a controlling entity with a dividend and also enable it to achieve some of its social policy objectives.

### **Control for Financial Reporting Purposes**

30. For the purposes of financial reporting, control stems from an entity's power to govern the financial and operating policies of another entity and does not necessarily require an entity to hold a majority shareholding or other equity interest in the other entity. The power to control must be presently exercisable. That is, the entity must already have had this power conferred upon it by legislation or some formal agreement. The power to control is not presently exercisable if it requires changing legislation or renegotiating agreements in order to be effective. This should be distinguished from the fact that the existence of the power to control another entity is not dependent upon the probability or likelihood of that power being exercised.
31. Similarly, the existence of control does not require an entity to have responsibility for the management of (or involvement in) the day-to-day operations of the other entity. In many cases, an entity may only exercise its power to control another entity where there is a breach or revocation of an agreement between the controlled entity and its controlling entity.
32. For example, a government department may have an ownership interest in a rail authority, which operates as a GBE. The rail authority is allowed to operate autonomously and does not rely on the government for funding but has raised capital through significant borrowings that are guaranteed by the government. The rail authority has not returned a dividend to government for several years. The government has the power to appoint and remove a majority of the members of the governing body of the rail authority. The government has never exercised the power to remove members of the governing body and would be reluctant to do so because of sensitivity in the electorate regarding the previous government's involvement in the operation of the rail network. In this case, the power to control is presently exercisable but under the existing relationship between the controlled entity and controlling entity, an event has not occurred to

warrant the controlling entity exercising its powers over the controlled entity. Accordingly, control exists because the power to control is sufficient even though the controlling entity may choose not to exercise that power.

33. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity voting power or reduce another party's voting power over the financial and operating policies of another entity (potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by another entity, are considered when assessing whether an entity has the power to govern the financial and operating policies of another entity. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.
34. In assessing whether potential voting rights contribute to control, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other contractual arrangements whether considered individually or in combination) that affect potential voting rights, except the intention of management and the financial ability to exercise or convert.
35. The existence of separate legislative powers does not, of itself, preclude an entity from being controlled by another entity. For example, the Office of the Government Statistician usually has statutory powers to operate independently of the government. That is, the Office of the Government Statistician may have the power to obtain information and report on its findings without recourse to government or any other body. The existence of control does not require an entity to have responsibility over the day-to-day operations of another entity or the manner in which professional functions are performed by the entity.
36. The power of one entity to govern decision-making in relation to the financial and operating policies of another entity is insufficient, in itself, to ensure the existence of control as defined in this Standard. The controlling entity needs to be able to govern decision-making so as to be able to benefit from its activities, for example by enabling the other entity to operate with it as part of an economic entity in pursuing its objectives. This will have the effect of excluding from the definitions of a "controlling entity" and "controlled entity" relationships which do not extend beyond, for instance, that of a liquidator and the entity being liquidated, and would normally exclude a lender and borrower relationship. Similarly, a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee would not be considered to control the trust for the purposes of this Standard.

**Regulatory and Purchase Power**

37. Governments and their agencies have the power to regulate the behavior of many entities by use of their sovereign or legislative powers. Regulatory and purchase powers do not constitute control for the purposes of financial reporting. To ensure that the financial statements of public sector entities include only those resources that they control and can benefit from, the meaning of control for the purposes of this Standard does not extend to:
- (a) The power of the legislature to establish the regulatory framework within which entities operate and to impose conditions or sanctions on their operations. Such power does not constitute control by a public sector entity of the assets deployed by these entities. For example, a pollution control authority may have the power to close down the operations of entities that are not complying with environmental regulations. However, this power does not constitute control because the pollution control authority only has the power to regulate; or
  - (b) Entities that are economically dependent on a public sector entity. That is, where an entity retains discretion as to whether it will take funding from, or do business with, a public sector entity, that entity has the ultimate power to govern its own financial or operating policies, and accordingly is not controlled by the public sector entity. For example, a government department may be able to influence the financial and operating policies of an entity which is dependent on it for funding (such as a charity) or a profit-orientated entity that is economically dependent on business from it. Accordingly, the government department has some power as a purchaser but not to govern the entity's financial and operating policies.

**Determining Whether Control Exists for Financial Reporting Purposes**

38. Public sector entities may create other entities to achieve some of their objectives. In some cases it may be clear that an entity is controlled, and hence should be consolidated. In other cases it may not be clear. Paragraphs 39 and 40 provide guidance to help determine whether or not control exists for financial reporting purposes.
39. In examining the relationship between two entities, control is presumed to exist when at least one of the following power conditions and one of the following benefit conditions exists, unless there is clear evidence of control being held by another entity.

*Power conditions*

- (a) The entity has, directly or indirectly through controlled entities, ownership of a majority voting interest in the other entity.

- (b) The entity has the power, either granted by or exercised within existing legislation, to appoint or remove a majority of the members of the board of directors or equivalent governing body and control of the other entity is by that board or by that body.
- (c) The entity has the power to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of the other entity.
- (d) The entity has the power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the other entity is by that board or by that body.

*Benefit conditions*

- (a) The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations. For example the benefit condition may be met if an entity had responsibility for the residual liabilities of another entity.
  - (b) The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.
40. When one or more of the circumstances listed in paragraph 39 does not exist, the following factors are likely, either individually or collectively, to be indicative of the existence of control.

*Power indicators*

- (a) The entity has the ability to veto operating and capital budgets of the other entity.
- (b) The entity has the ability to veto, overrule, or modify governing body decisions of the other entity.
- (c) The entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity.
- (d) The mandate of the other entity is established and limited by legislation.
- (e) The entity holds a golden share<sup>1</sup> (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that other entity.

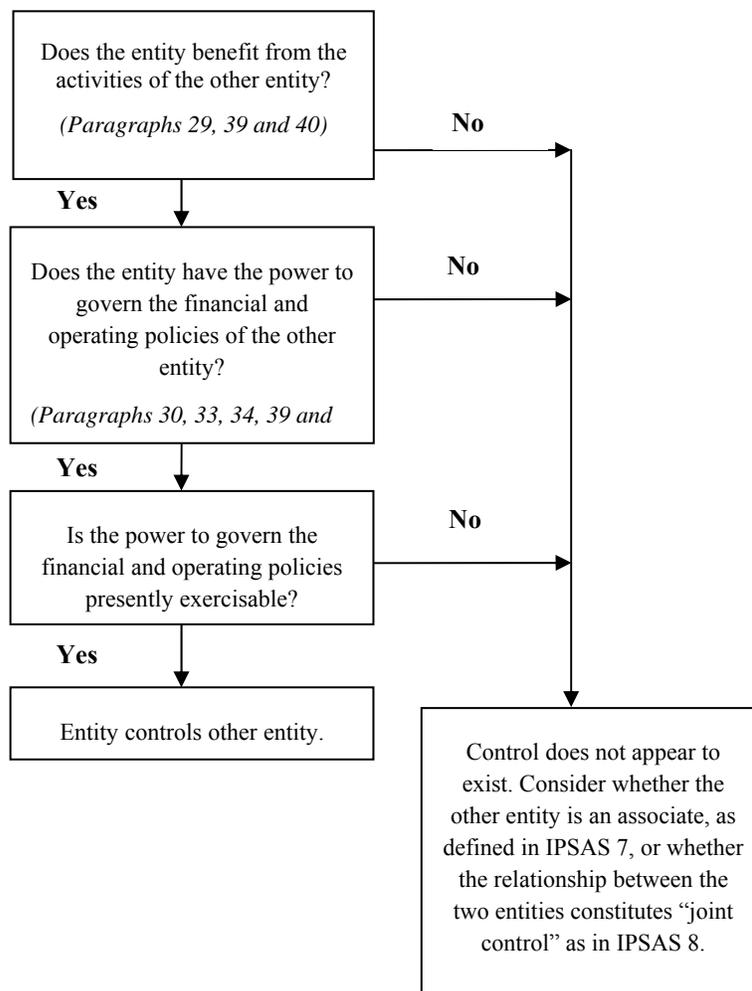
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<sup>1</sup> Golden share refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associated with the holder's ownership interest or representation on the governing body.

*Benefit indicators*

- (a) The entity holds direct or indirect title to the net assets/equity of the other entity with an ongoing right to access these.
  - (b) The entity has a right to a significant level of the net assets/equity of the other entity in the event of a liquidation or in a distribution other than a liquidation.
  - (c) The entity is able to direct the other entity to co-operate with it in achieving its objectives.
  - (d) The entity is exposed to the residual liabilities of the other entity.
41. The following diagram indicates the basic steps involved in establishing control of another entity. It should be read in conjunction with paragraphs 28 to 40.

**Establishing Control of another Entity for Financial Reporting Purposes**



42. A controlling entity loses control when it loses the power to govern the financial and operating policies of a controlled entity so as to benefit from its activities. The loss of control can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when a controlled entity becomes subject to the control of another government, a court, administrator or regulator. It could also occur as a result of a contractual agreement or, for example, a foreign government may sequester the operating assets of a foreign controlled entity so that the controlling entity loses the power to govern the operating policies of the controlled entity. In this case, control is unlikely to exist.

### **Consolidation Procedures**

43. In preparing consolidated financial statements, an entity combines the financial statements of the controlling entity and its controlled entities line by line by adding together like items of assets, liabilities, net assets/equity, revenue and expenses. In order that the consolidated financial statements present financial information about the economic entity as that of a single entity, the following steps are then taken:
- (a) The carrying amount of the controlling entity's investment in each controlled entity and the controlling entity's portion of net assets/equity of each controlled entity are eliminated ( the relevant international or national accounting standard dealing with business combinations provides guidance on the treatment of any resultant goodwill);
  - (b) Minority interests in the surplus or deficit of consolidated controlled entities for the reporting period are identified; and
  - (c) Minority interests in the net assets/equity of consolidated controlled entities are identified separately from the controlling entity's net assets/equity in them. Minority interests in the net assets/equity consist of:
    - (i) The amount of those minority interests at the date of the original combination (the relevant international or national accounting standard dealing with business combinations provides guidance on calculating this amount); and
    - (ii) The minority's share of changes in net assets/equity since the date of combination.
44. When potential voting rights exist, the proportions of surplus or deficit and changes in net assets/equity allocated to the controlling entity and minority interests are determined on the basis of present ownership interests and do not reflect the possible exercise or conversion of potential voting rights.
45. **Balances, transactions, revenues and expenses between entities within the economic entity shall be eliminated in full.**

46. Balances and transactions between entities within the economic entity, including revenues from sales and transfers, revenues recognized consequent to an appropriation or other budgetary authority, expenses and dividends or similar distributions, are eliminated in full. Surpluses and deficits resulting from transactions within the economic entity that are recognized in assets, such as inventory and fixed assets, are eliminated in full. Deficits within the economic entity may indicate an impairment that requires recognition in the consolidated financial statements. Guidance on accounting for temporary differences that arise from the elimination of surpluses and deficits resulting from transactions within the economic entity, can be found in the relevant international or national accounting standard dealing with income taxes.
47. **The financial statements of the controlling entity and its controlled entities used in the preparation of the consolidated financial statements shall be prepared as of the same reporting date. When the reporting dates of the controlling entity and a controlled entity are different, the controlled entity prepares, for consolidation purposes, additional financial statements as of the same date as the financial statements of the controlling entity unless it is impracticable to do so.**
48. **When in accordance with paragraph 47, the financial statements of a controlled entity used in the preparation of consolidated financial statements are prepared as of a reporting date different from that of the controlling entity, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the controlling entity's financial statements. In any case, the difference between the reporting date of the controlled entity and that of the controlling entity shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.**
49. **Consolidated financial statements shall be prepared using uniform accounting policies for like transactions and other events in similar circumstances.**
50. If a member of the economic entity uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.
51. The revenue and expenses of a controlled entity are included in the consolidated financial statements from the acquisition date (the relevant international or national accounting standard dealing with business combinations provides guidance on the meaning of the acquisition date). The revenue and expenses of a controlled entity are included in the consolidated financial statements until the date on which the controlling entity ceases to control the controlled entity. The difference between the proceeds from the

disposal of the controlled entity and its carrying amount as of the date of disposal, including the cumulative amount of any exchange differences that relate to the controlled entity recognized in net assets/equity in accordance with IPSAS 4, “The Effects of Changes in Foreign Exchange Rates,” is recognized in the consolidated statement of financial performance as the gain or loss on the disposal of the controlled entity.

52. From the date an entity ceases to be a controlled entity, provided that it does not become an associate as defined in IPSAS 7 or a jointly controlled entity as defined in IPSAS 8, it shall be accounted for as a financial instrument. The relevant international or national accounting standard dealing with the recognition and measurement of financial instruments provides guidance on accounting for financial instruments.
53. The carrying amount of the investment at the date that the entity ceases to be a controlled entity shall be regarded as the cost on initial measurement of a financial instrument.
54. **Minority interests shall be presented in the consolidated statement of financial position within net assets/equity, separately from the controlling entity’s net assets/equity. Minority interests in the surplus or deficit of the economic entity shall also be separately disclosed.**
55. The surplus or deficit is attributed to the controlling entity and minority interests. Because both are net assets/equity, the amount attributed to minority interests is not revenue or expense.
56. Losses applicable to the minority in a consolidated controlled entity may exceed the minority interest in the controlled entity’s net assets/equity. The excess, and any further losses applicable to the minority, are allocated against the majority interest except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. If the controlled entity subsequently reports surpluses, such surpluses are allocated to the majority interest until the minority’s share of losses previously absorbed by the majority has been recovered.
57. If a controlled entity has outstanding cumulative preference shares that are held by minority interests and classified as net assets/equity, the controlling entity computes its share of surpluses or deficits after adjusting for the dividends on such shares, whether or not dividends have been declared.

### **Accounting for Controlled Entities, Jointly Controlled Entities and Associates in Separate Financial Statements**

58. **When separate financial statements are prepared, investments in controlled entities, jointly controlled entities and associates shall be accounted for:**
  - (a) **Using the equity method as described in IPSAS 7;**

- (b) **At cost; or**
- (c) **As financial instruments.**

**The same accounting shall be applied for each category of investments.**

59. This Standard does not mandate which entities produce separate financial statements available for public use. Paragraphs 58 and 60-64 apply when an entity prepares separate financial statements that comply with International Public Sector Accounting Standards. The entity also produces consolidated financial statements available for public use as required by paragraph 15, unless the exemption provided in paragraph 16 is applicable.
60. **Controlled entities, jointly controlled entities and associates that are accounted for as financial instruments in the consolidated financial statements shall be accounted for in the same way in the investor's separate financial statements.**
61. Guidance on accounting for financial instruments can be found in the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.

### **Disclosure**

62. **The following disclosures shall be made in consolidated financial statements:**
- (a) **A list of significant controlled entities;**
  - (b) **The fact that a controlled entity is not consolidated in accordance with paragraph 21;**
  - (c) **Summarized financial information of controlled entities, either individually or in groups, that are not consolidated, including the amounts of total assets, total liabilities, revenues and surplus or deficit;**
  - (d) **The name of any controlled entity in which the controlling entity holds an ownership interest and/or voting rights of 50% or less, together with an explanation of how control exists;**
  - (e) **The reasons why the ownership interest of more than 50% of the voting or potential voting power of an investee does not constitute control;**
  - (f) **The reporting date of the financial statements of a controlled entity when such financial statements are used to prepare consolidated financial statements and are as of a reporting date or for a period that is different from that of the controlling entity, and the reason for using a different reporting date or period; and**

- (g) **The nature and extent of any significant restrictions (e.g. resulting from borrowing arrangements or regulatory requirements) on the ability of controlled entities to transfer funds to the controlling entity in the form of cash dividends, or similar distributions, or to repay loans or advances.**
63. **When separate financial statements are prepared for a controlling entity that, in accordance with paragraph 16, elects not to prepare consolidated financial statements, those separate financial statements shall disclose:**
- (a) **The fact that the financial statements are separate financial statements; that the exemption from consolidation has been used; the name of the entity whose consolidated financial statements that comply with International Public Sector Accounting Standards have been produced for public use and the jurisdiction in which the entity operates (when it is different from that of the controlling entity); and the address where those consolidated financial statements are obtainable;**
  - (b) **A list of significant controlled entities, jointly controlled entities and associates, including the name, the jurisdiction in which the entity operates (when it is different from that of the controlling entity), proportion of ownership interest and, where that interest is in the form of shares, the proportion of voting power held (only where this is different from the proportionate ownership interest); and**
  - (c) **A description of the method used to account for the entities listed under (b).**
64. **When a controlling entity (other than a controlling entity covered by paragraph 63), venturer with an interest in a jointly controlled entity or an investor in an associate prepares separate financial statements, those separate financial statements shall disclose:**
- (a) **The fact that the statements are separate financial statements and the reasons why those statements are prepared if not required by law, legislation or other authority;**
  - (b) **A list of significant controlled entities, jointly controlled entities and associates, including the name, the jurisdiction in which the entity operates (when it is different from that of the controlling entity), proportion of ownership interest and, where that interest is in the form of shares, the proportion of voting power held (only where this is different from the proportionate ownership interest); and**
  - (c) **A description of the method used to account for the entities listed under (b);**

and shall identify the financial statements prepared in accordance with paragraph 15 of this Standard, IPSAS 7 and IPSAS 8 to which they relate.

### Transitional Provisions

65. **Entities are not required to comply with the requirement in paragraph 45 concerning the elimination of balances and transactions between entities within the economic entity for reporting periods beginning on a date within three years following the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards.**
66. Controlling entities that adopt accrual accounting for the first time in accordance with International Public Sector Accounting Standards may have many controlled entities with significant number of transactions between these entities. Accordingly, it may be difficult to identify some transactions and balances that need to be eliminated for the purpose of preparing the consolidated financial statements of the economic entity. For this reason, paragraph 65 provides relief from the requirement to eliminate balances and transactions between entities within the economic entity in full.
67. **Where entities apply the transitional provision in paragraph 65, they shall disclose the fact that not all balances and transactions occurring between entities within the economic entity have been eliminated.**
68. Transitional provisions in IPSAS 6 (2000) provide entities with a period of up to three years to fully eliminate balances and transactions between entities within the economic entity from the date of its first application. Entities that have previously applied IPSAS 6 (2000) may continue to take advantage of this three-year transitional period from the date of first application of IPSAS 6 (2000).

### Effective Date

69. **An entity shall apply this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
70. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

**Withdrawal of IPSAS 6 (2000)**

71. This Standard supersedes IPSAS 6, “Consolidated Financial Statements and Accounting for Controlled Entities” issued in 2000.

## Appendix

### Amendments to Other IPSASs

*The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after January 1, 2008. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.*

- A1. In International Public Sector Accounting Standards applicable at January 1, 2008, references to the current version of IPSAS 6, “Consolidated Financial Statements and Accounting for Controlled Entities” are amended to IPSAS 6, “Consolidated and Separate Financial Statements.”
- A2. The following is added to paragraph 4(f) of IPSAS 15, “Financial Instruments: Disclosure and Presentation”:

**However, entities shall apply this Standard to an interest in a controlling entity, associate or joint venture that according to IPSAS 6, IPSAS 7 or IPSAS 8 is accounted for as a financial instrument. In these cases, entities shall apply the disclosure requirements in IPSAS 6, IPSAS 7 and IPSAS 8 in addition to those in this Standard.**

## **Implementation Guidance—Consideration of Potential Voting Rights**

### **Guidance on implementing IPSAS 6, “Consolidated and Separate Financial Statements,” IPSAS 7, “Investments in Associates” and IPSAS 8, “Interests in Joint Ventures.”**

*This guidance accompanies IPSAS 6, IPSAS 7 and IPSAS 8, but is not part of them.*

#### **Introduction**

- IG1. Most public sector entities do not issue financial instruments with potential voting rights. However, they may be issued by GBEs. Therefore, a government or other public sector entity may hold potential voting rights of GBEs.
- IG2. Paragraphs 33, 34 and 44 of IPSAS 6, “Consolidated and Separate Financial Statements” and paragraphs 14 and 15 of IPSAS 7, “Investments in Associates” require an entity to consider the existence and effect of all potential voting rights that are currently exercisable or convertible. They also require all facts and circumstances that affect potential voting rights to be examined, except the intention of management and the financial ability to exercise or convert potential voting rights. Because the definition of joint control in paragraph 6 of IPSAS 8, “Interests in Joint Ventures” depends upon the definition of control, and because that Standard is linked to IPSAS 7 for application of the equity method, this guidance is also relevant to IPSAS 8.

#### **Guidance**

- IG3. Paragraph 7 of IPSAS 6 defines control as the power to govern the financial and operating policies of an entity so as to benefit from its activities. Paragraph 7 of IPSAS 7 defines significant influence as the power to participate in the financial and operating policy decisions of the investee but not to control those policies. Paragraph 6 of IPSAS 8 defines joint control as the agreed sharing of control over an activity by a binding agreement. In these contexts, power refers to the ability to do or affect something. Consequently, an entity has control, joint control or significant influence when it currently has the ability to exercise that power, regardless of whether control, joint control or significant influence is actively demonstrated or is passive in nature. Potential voting rights held by an entity that are currently exercisable or convertible provide this ability. The ability to exercise power does not exist when potential voting rights lack economic substance (e.g., the exercise price is set in a manner that precludes exercise or conversion in any feasible scenario). Consequently, potential voting rights are considered when, in substance, they provide the ability to exercise power.
- IG4. Control and significant influence also arise in the circumstances described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7 respectively, which include consideration of the relative ownership of voting

rights. IPSAS 8 depends on IPSAS 6 and IPSAS 7 and references to IPSAS 6 and IPSAS 7 from this point onwards should be read as being relevant to IPSAS 8. Nevertheless it should be borne in mind that joint control involves sharing of control by a binding agreement and this aspect is likely to be the critical determinant. Potential voting rights such as share call options and convertible debt are capable of changing an entity's voting power over another entity—if the potential voting rights are exercised or converted, then the relative ownership of the ordinary shares carrying voting rights changes. Consequently, the existence of control (the definition of which permits only one entity to have control of another entity) and significant influence are determined only after assessing all the factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7 respectively, and considering the existence and effect of potential voting rights. In addition, the entity examines all facts and circumstances that affect potential voting rights except the intention of management and the financial ability to exercise or convert. The intention of management does not affect the existence of power and the financial ability of an entity to exercise or convert is difficult to assess.

- IG5. An entity may initially conclude that it controls or significantly influences another entity after considering the potential voting rights that it can currently exercise or convert. However, the entity may not control or significantly influence the other entity when potential voting rights held by other parties are also currently exercisable or convertible. Consequently, an entity considers all potential voting rights held by it and by other parties that are currently exercisable or convertible when determining whether it controls or significantly influences another entity. For example, all share call options are considered, whether held by the entity or another party. Furthermore, the definition of control in paragraph 7 of IPSAS 6 permits only one entity to have control of another entity. Therefore, when two or more entities each hold significant voting rights, both actual and potential, the factors in paragraphs 39 and 40 of IPSAS 6 are reassessed to determine which entity has control.
- IG6. The proportion allocated to the controlling entity and minority interests in preparing consolidated financial statements in accordance with IPSAS 6, and the proportion allocated to an investor that accounts for its investment using the equity method in accordance with IPSAS 7, are determined solely on the basis of present ownership interests. The proportion allocated is determined taking into account the eventual exercise of potential voting rights and other derivatives that, in substance, give access at present to the economic benefits associated with an ownership interest.
- IG7. In some circumstances an entity has, in substance, a present ownership as a result of a transaction that gives it access to the economic benefits or service potential associated with an ownership interest. In such circumstances, the proportion allocated is determined taking into account the eventual exercise of

those potential voting rights and other derivatives that give the entity access to the economic benefits at present.

- IG8. The relevant international or national accounting standard dealing with the recognition and measurement of financial instruments provides guidance on accounting for financial instruments. However, it does not apply to interests in controlled entities, associates and jointly controlled entities that are consolidated, accounted for using the equity method or proportionately consolidated in accordance with IPSAS 6, IPSAS 7 and IPSAS 8 respectively. When instruments containing potential voting rights in substance currently give access to the economic benefits or service potential associated with an ownership interest, and the investment is accounted for in one of the above ways, the instruments are not subject to the requirements of the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments. In all other cases, guidance on accounting for instruments containing potential voting rights can be found in the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.

### **Illustrative Examples**

- IG9. The ten examples below each illustrate one aspect of a potential voting right. In applying IPSAS 6, IPSAS 7 or IPSAS 8, an entity considers all aspects. The existence of control, significant influence and joint control can be determined only after assessing the other factors described in IPSAS 6, IPSAS 7 and IPSAS 8. For the purpose of these examples, however, those other factors are presumed not to affect the determination, even though they may affect it when assessed.

#### *Example 1A: Options are out of the money*

Entities A and B own 80 percent and 20 percent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity A sells one-half of its interest to Entity D and buys call options from Entity D that are exercisable at any time at a premium to the market price when issued, and if exercised would give Entity A its original 80 percent ownership interest and voting rights.

Though the options are out of the money, they are currently exercisable and give Entity A the power to continue to set the operating and financial policies of Entity C, because Entity A could exercise its options now. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6, are considered and it is determined that Entity A controls Entity C.

*Example 1B: Right to Purchase at Premium to Fair Value*

The municipalities of Dunelm and Eboracum own 80 percent and 20 percent respectively of Dunelm-Eboracum General Hospital, a public sector entity established by charter. The hospital is managed by a board of ten trustees, appointed by the municipalities in proportion to their ownership interest of the hospital. The charter permits either municipality to sell part or its entire ownership interest in the hospital to another municipality within the region. Dunelm sells one-half of its interest to the municipality of Formio, however the sale contract gives Dunelm the right to repurchase Formio's interest in the hospital at an amount equal to 115 percent of the fair value of the ownership interest determined by an independent valuer. This right is exercisable at any time and, if exercised would give Dunelm its original 80 percent ownership interest and the right to appoint trustees accordingly.

Although the right to reacquire the ownership interest sold to Formio would involve paying a premium over the fair value, the right is currently exercisable and gives Dunelm the power to continue to set the operating and financial policies of the Dunelm-Eboracum General Hospital, because Dunelm could exercise its right to reacquire Formio's interest now. The existence of the potential right to appoint trustees, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6, are considered and it is determined that the municipality of Dunelm controls the Dunelm-Eboracum General Hospital.

*Example 2A: Possibility of exercise or conversion*

Entities A, B and C own 40 percent, 30 percent and 30 percent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entity A also owns call options that are exercisable at any time at the fair value of the underlying shares and if exercised would give it an additional 20 percent of the voting rights in Entity D and reduce Entity B's and Entity C's interests to 20 percent each. If the options are exercised, Entity A will have control over more than one-half of the voting power. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7, are considered and it is determined that Entity A controls Entity D.

*Example 2B: Possibility of exercise of rights*

The federal government of Arandis, in agreement with the state governments of Brixia and Mutina, establishes the University of Pola-Iluro. The University of Pola-Iluro is near the cities of Pola, Brixia and Iluro, Mutina, which are located next to each other on the border between the two states. The federal legislation that establishes the University of Pola-Iluro provides that the federal minister of education has the right to appoint four of the ten governors that manage the university. The state ministers of education of Brixia and Mutina are given the

right to appoint three governors each. The legislation also provides that the federal government has ownership of 40 percent of the university's net assets, with the state governments having 30 percent each. The federal legislation gives the federal minister of education the right to acquire an additional 20 percent of the ownership in the university's net assets, with the right to appoint an additional two governors. This right is exercisable at any time, at the discretion of the federal minister. It requires the federal government to pay each state government the fair value of the net assets of the university acquired. If the federal government exercises its right, it would own 60 percent of the net assets of the university, and have the right to appoint six of the ten governors. This would reduce the state governments' ownership to 20 percent each, with the right to appoint only two governors each.

The existence of the potential right to appoint the majority of the university's governors, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7, are considered and it is determined that the federal government of Arandis controls the University of Pola-Iluro.

*Example 3A: Other rights that have the potential to increase an entity's voting power or reduce another entity's voting power*

Entities A, B and C own 25 percent, 35 percent and 40 percent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities B and C also have share warrants that are exercisable at any time at a fixed price and provide potential voting rights. Entity A has a call option to purchase these share warrants at any time for a nominal amount. If the call option is exercised, Entity A would have the potential to increase its ownership interest, and thereby its voting rights, in Entity D to 51 percent (and dilute Entity B's interest to 23 percent and Entity C's interest to 26 percent).

Although the share warrants are not owned by Entity A, they are considered in assessing control because they are currently exercisable by Entities B and C. Normally, if an action (e.g., purchase or exercise of another right) is required before an entity has ownership of a potential voting right, the potential voting right is not regarded as held by the entity. However, the share warrants are, in substance, held by Entity A, because the terms of the call option are designed to ensure Entity A's position. The combination of the call option and share warrants gives Entity A the power to set the operating and financial policies of Entity D, because Entity A could currently exercise the option and share warrants. The other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7 are also considered, and it is determined that Entity A, not Entity B or C, controls Entity D.

*Example 3B: Other rights that have the potential to increase an entity's voting power or reduce another entity's voting power*

The cities of Deva, Oxonia and Isca own 25 percent, 35 percent and 40 percent respectively of the Deva-Oxonia-Isca Electricity Generating Authority, a public sector entity established by charter. The charter gives the cities voting rights in the management of the Authority and the right to receive the electricity generated by the Authority. The voting rights and electricity access are in proportion to their ownership in the Authority. The charter gives Oxonia and Isca rights to increase their ownership (and therefore voting rights) in the Authority each by 10 percent at any time at a commercial price agreed by the three cities. The charter also gives Deva the right to acquire 15 percent interest of the Authority from Oxonia and 20 percent from Isca at any time for a nominal consideration. If Deva exercised the right, Deva would increase its ownership interest, and thereby its voting rights, in Deva-Oxonia-Isca Electric Generating Authority to 60 percent. This would dilute Oxonia's ownership to 20 percent and Isca's to 20 percent.

Although the charter gives Oxonia and Isca the right to increase their proportion of ownership, the overarching right of Deva to acquire a majority interest in the Authority for a nominal consideration set out in the charter is, in substance, designed to ensure Deva's position. The right held by Deva gives Deva the capacity to set the operating and financial policies of the Deva-Oxonia-Isca Electricity Generating Authority, because Deva could exercise the right to increase its ownership and therefore voting rights at any time. The other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7 are also considered, and it is determined that Deva, not Oxonia or Isca, controls the Deva-Oxonia-Isca Electricity Generating Authority.

*Example 4A: Management intention*

Entities A, B and C each own 33⅓ percent of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity D. Entities A, B and C each have the right to appoint two directors to the board of Entity D. Entity A also owns call options that are exercisable at a fixed price at any time and if exercised would give it all the voting rights in Entity D. The management of Entity A does not intend to exercise the call options, even if Entities B and C do not vote in the same manner as Entity A. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7, are considered and it is determined that Entity A controls Entity D. The intention of Entity A's management does not influence the assessment.

*Example 4B: Management Intention*

The cities of Tolosa, Lutetia and Massilia each own 33 1/3 percent of TLM Water Commission, a public sector entity established by charter to reticulate drinking water to the cities of Tolosa, Lutetia and Massilia and a number of outlying towns and villages. The charter gives each city an equal vote in the governance of the Commission, and the right to appoint two Commissioners each. The Commissioners manage the Commission on behalf of the cities. The charter also gives the city of Tolosa the right to acquire the ownership of Lutetia and Massilia at a fixed price, exercisable at any time by the Mayor of Tolosa. If exercised Tolosa would have sole governance of the Commission with the right to appoint all the Commissioners. The Mayor of Tolosa does not intend to exercise the right to acquire full ownership of Commission, even if the Commissioners appointed by Lutetia and Massilia vote against those appointed by Tolosa. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7, are considered and it is determined that Tolosa controls TLM Water Commission. The intention of the Mayor of Tolosa does not influence the assessment.

*Example 5A: Financial ability*

Entities A and B own 55 percent and 45 percent respectively of the ordinary shares that carry voting rights at a general meeting of shareholders of Entity C. Entity B also holds debt instruments that are convertible into ordinary shares of Entity C. The debt can be converted at a substantial price, in comparison with Entity B's net assets, at any time and if converted would require Entity B to borrow additional funds to make the payment. If the debt were to be converted, Entity B would hold 70 percent of the voting rights and Entity A's interest would reduce to 30 percent.

Although the debt instruments are convertible at a substantial price, they are currently convertible and the conversion feature gives Entity B the power to set the operating and financial policies of Entity C. The existence of the potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6, are considered and it is determined that Entity B, not Entity A, controls Entity C. The financial ability of Entity B to pay the conversion price does not influence the assessment.

*Example 5B: Financial ability*

The cities of Melina and Newton own 55 percent and 45 percent respectively of the interests that carry voting rights of MN Broadcasting Authority, a public sector entity established by charter to provide broadcasting and television services for the regions. The charter gives the city of Newton the option to buy additional 25 percent interest of the

Authority from the city of Melina at a substantial price, in comparison with the city of Newton's net assets, at any time. If exercised it would require the city of Newton to borrow additional funding to make the payment. If the option were to be exercised, the city of Newton would hold 70 percent of the voting rights and the city of Melina's interest would reduce to 30 percent.

Although the option is exercisable at a substantial price, it is currently exercisable and the exercise feature gives the city of Newton the power to set the operating and financial policies of MN Broadcasting Authority. The existence of potential voting rights, as well as the other factors described in paragraphs 39 and 40 of IPSAS 6, are considered and it is determined that the city of Newton, not the city of Melina, controls MN Broadcasting Authority. The financial ability of the city of Newton to pay the exercise price does not influence the assessment.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the proposed IPSASs. This Basis for Conclusions only notes the IPSASB's reasons for departing from the provisions of the related IAS.*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)'s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS is not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the "comparison with IFRS" included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 6, issued in May 2000 was based on IAS 27 (Reformatted 1994), "Consolidated Financial Statements and Accounting for Controlled Entities" which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 27 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The

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<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

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- BC6. The IPSASB has departed from the provisions of IAS 27 in that it has decided to retain the equity method as a method of accounting for controlled entities in the separate financial statements of controlling entities. The IPSASB is aware that views on this treatment are evolving and that it is not necessary at this time to remove the equity method as an option.
- BC7. IAS 27 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 6 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

## **Comparison with IAS 27**

International Public Sector Accounting Standard IPSAS 6, “Consolidated and Separate Financial Statements” is drawn primarily from International Accounting Standard IAS 27, “Consolidated and Separate Financial Statements” (2003). At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 5, “Non-current Assets Held for Sale and Discontinued Operations”, to public sector entities; therefore IPSAS 6 does not reflect amendments made to IAS 27 consequent upon the issue of International Financial Reporting Standard IFRS 5. The main differences between IPSAS 6 and IAS 27 are as follows:

- Commentary additional to that in IAS 27 has been included in IPSAS 6 to clarify the applicability of the Standard to accounting by public sector entities.
- IPSAS 6 contains specific guidance on whether control exists in a public sector context (paragraphs 28-41).
- IPSAS 6 uses different terminology, in certain instances, from IAS 27. The most significant examples are the use of the terms statement of financial performance, statement of financial position, net assets/equity, economic entity, controlling entity and controlled entity in IPSAS 6. The equivalent terms in IAS 27 are income statement, balance sheet, equity, group, parent and subsidiary.
- IPSAS 6 does not use the term income, which in IAS 27 has a broader meaning than the term revenue.
- IPSAS 6 permits entities to use the equity method to account for controlled entities in the separate financial statements of controlling entities.
- IPSAS 6 requires controlling entities to disclose a list of significant controlled entities in consolidated financial statements (paragraph 62(a)). IAS 27 does not require this disclosure. IPSAS 6 includes a transitional provision that permits entities to not eliminate all balances and transactions between entities within the economic entity for reporting periods beginning on a date within three years following the date of first adoption of this Standard (paragraphs 65-68). IAS 27 does not contain transitional provisions.
- IPSAS 6 contains five additional illustrative examples that reflect the public sector context in Implementation Guidance.

## IPSAS 7—INVESTMENTS IN ASSOCIATES

### Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 28 (Revised 2003), “Investments in Associates” published by the International Accounting Standards Board (IASB). Extracts from IAS 28 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of International Accounting Standards Committee Foundation (IASCF).

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International Public Sector Accounting Standard 7, “Investments in Associates” (IPSAS 7) is set out in paragraphs 1-49 and the Appendix. All the paragraphs have equal authority. IPSAS 7 should be read in the context of the Basis for Conclusion (if any), and the “Preface to the International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

IN1. International Public Sector Accounting Standard (IPSAS) 7, “Investments in Associates,” replaces IPSAS 7, “Accounting for Investments in Associates” (issued May 2000), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## Reasons for Revising IPSAS 7

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 7 as a response to the International Accounting Standards Board’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 7, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 28, “Accounting for Investment in Associates” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 28 for a public sector specific reason; such variances are retained in this IPSAS 7 and are noted in the Comparison with IAS 28. Any changes to IAS 28 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 7.

## Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 7 are described below.

### Name of Standard

IN5. The name of the Standard has been changed to “Investments in Associates.”

### Scope

IN6. The Standard now excludes in paragraph 1 investments that would otherwise be associates or joint ventures held by venture capital organizations, mutual funds, unit trusts and similar entities that are measured at fair value in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.

IN7. The Standard provides exemptions from application of the equity method to certain:

- Controlling entities, similar to those provided for financial statements in IPSAS 6, “Consolidated and Separate Financial Statements” (in paragraph 19(b)); and
- Investors which satisfy the same type of conditions that exempt controlling entities in preparing consolidated financial statements in paragraph 19(c).

**Definitions**

IN8. The Standard modifies the definitions of equity method and significant influence for uniform definitions in IPSASs in paragraph 7.

**Significant Influence**

IN9. The Standard requires in paragraphs 14-16 an entity to consider the existence and effect of potential voting rights currently exercisable or convertible when assessing whether it has the power to participate in the financial and operating policy decisions of the investee (associate).

**Application of the Equity Method**

IN10. The Standard clarifies in paragraph 19 that investments that are held exclusively with a view to its disposal within twelve months of acquisition and that management is actively seeking a buyer shall be classified as held for trading and will be accounted for in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.

IN11. The Standard clarifies in paragraph 24 that when an investor ceases to significantly influence its investment, the cost of the investment shall be accounted for in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.

IN12. The Standard requires in paragraph 28 that surpluses and deficits resulting from upstream and downstream transactions between an investor and an associate to be eliminated to the extent of the investor's interest in the associate.

IN13. The Standard allows a maximum of three months between the reporting period of the investor and its associate when applying the equity method (paragraph 31).

IN14. The Standard removes the impracticable notion in paragraph 33, such that an investor has to make appropriate adjustments for transactions and other events in the associate's financial statements when the accounting policies in both entities are not similar.

IN15. The Standard requires in paragraphs 35 and 36 the entity to consider the carrying amount of its investment in the equity of the associate and its other long-term interests in the associate when recognizing its share of losses of the associate.

**Impairment Losses**

IN16. The Standard provides guidance in paragraphs 37–40 on when and how an entity tests for impairment of its associate.

## Separate Financial Statements

IN17. The requirements and guidance for separate financial statements have been moved to IPSAS 6 in paragraphs 41 and 42. Entities will now have to refer to IPSAS 6 for guidance on how to prepare an investor's separate financial statements.

## Disclosure

IN18. The Standard requires in paragraph 43 more detailed disclosures on investments in associates, including:

- The nature and extent of any significant restrictions (e.g., resulting from borrowing arrangements) on the ability of associates to transfer funds to the investor;
- The unrecognized share of losses of an associate if any investor has discontinued recognition of its share of losses of an associate; and
- The reasons why:
  - An investment is considered to have significant influence when it holds less than 20 percent of the voting or potential voting power of the investee;
  - An investment is not considered to have significant influence when it holds more than 20 percent of the voting or potential voting power of the investee; and
  - The reporting date of the financial statements of the associate and investor is different.

**IPSAS 7—INVESTMENTS IN ASSOCIATES****Scope**

1. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting by an investor for investments in associates where the investment in the associate leads to the holding of an ownership interest in the form of a shareholding or other formal equity structure. However, it does not apply to investments in associates held by:**

- (a) **Venture capital organizations, or**
- (b) **Mutual funds, unit trusts and similar entities including investment-linked insurance funds.**

**that are measured at fair value, with changes in fair value recognized in surplus or deficit in the period of the change in accordance with relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.**

2. Guidance on recognition and measurement of interests identified in paragraph 1 that are measured at fair value, with changes in fair value recognized in surplus or deficit in the period of the change can be found in the relevant international or national accounting standard dealing with financial instruments.
3. This Standard provides the basis for accounting for ownership interests in associates. That is, the investment in the other entity confers on the investor the risks and rewards incidental to an ownership interest. The Standard applies only to investments in the formal equity structure (or its equivalent) of an investee. A formal equity structure means share capital or an equivalent form of unitized capital, such as units in a property trust, but may also include other equity structures in which the investor's interest can be measured reliably. Where the equity structure is poorly defined it may not be possible to obtain a reliable measure of the ownership interest.
4. Some contributions made by public sector entities may be referred to as an "investment" but may not give rise to an ownership interest. For example, a public sector entity may make a substantial investment in the development of a hospital that is owned and operated by a charity. Whilst such contributions are non-exchange in nature, they allow the public sector entity to participate in the operation of the hospital, and the charity is accountable to the public sector entity for its use of public monies. However, the contributions made by the public sector entity do not constitute an ownership interest, as the charity could seek alternative funding and thereby prevent the public sector entity from participating in the operation of the hospital. Accordingly, the public

sector entity is not exposed to the risks nor does it enjoy the rewards which are incidental to an ownership interest.

5. **This Standard applies to all public sector entities other than Government Business Enterprises.**
6. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”

## Definitions

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

**An associate** is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a controlled entity nor an interest in a joint venture.

**Consolidated financial statements** are the financial statements of an economic entity presented as those of a single economic entity.

**Control** is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

**Controlled entity** is an entity, including an unincorporated entity such as a partnership, that is subject to the control of another entity (known as the controlling entity).

The **equity method** is a method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor’s share of net assets/equity of the investee. The surplus or deficit of the investor includes the investor’s share of the surplus or deficit of the investee.

**Separate financial statements** are those presented by a controlling entity, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.

**Significant influence** (for the purpose of this Standard) is the power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.

Terms defined in other International Public Sector Accounting Standards are used in this Standard with the same meaning as in those

**other Standards, and are reproduced in the Glossary of Defined Terms published separately.**

8. Financial statements of an entity that does not have a controlled entity, associate or venturer's interest in a joint venture are not separate financial statements.
9. Separate financial statements are those presented in addition to consolidated financial statements, financial statements in which investments are accounted for using the equity method and financial statements in which the venturer's interests in joint ventures are proportionately consolidated. Separate financial statements may or may not be appended to, or accompany, those financial statements.
10. Entities that are exempted in accordance with paragraph 16 of IPSAS 6, "Consolidated and Separate Financial Statements" from consolidation, paragraph 3 of IPSAS 8, "Interests in Joint Ventures" from applying proportionate consolidation or paragraph 19(c) of this Standard from applying the equity method may present separate financial statements as their only financial statements.

### **Significant Influence**

11. Whether an investor has significant influence over the investee is a matter of judgment based on the nature of the relationship between the investor and the investee, and on the definition of significant influence in this Standard. This Standard applies only to those associates in which an entity holds an ownership interest.
12. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:
  - (a) Representation on the board of directors or equivalent governing body of the investee;
  - (b) Participation in policy-making processes, including participation in decisions about dividends or other distributions;
  - (c) Material transactions between the investor and the investee;
  - (d) Interchange of managerial personnel; or
  - (e) Provision of essential technical information.
13. If the investor's ownership interest is in the form of shares and it holds, directly or indirectly (e.g., through controlled entities), 20 percent or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly (e.g., through controlled entities), less than 20 percent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such

influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.

14. An entity may own share warrants, share call options, debt or equity instruments that are convertible into ordinary shares, or other similar instruments that have the potential, if exercised or converted, to give the entity additional voting power or reduce another party's voting power over the financial and operating policies of another entity (i.e., potential voting rights). The existence and effect of potential voting rights that are currently exercisable or convertible, including potential voting rights held by other entities, are considered when assessing whether an entity has significant influence. Potential voting rights are not currently exercisable or convertible when, for example, they cannot be exercised or converted until a future date or until the occurrence of a future event.
15. In assessing whether potential voting rights contribute to significant influence, the entity examines all facts and circumstances (including the terms of exercise of the potential voting rights and any other binding arrangements whether considered individually or in combination) that affect potential rights, except the intention of management and the financial ability to exercise or convert.
16. An entity loses significant influence over an investee when it loses the power to participate in the financial and operating policy decisions of that investee. The loss of significant influence can occur with or without a change in absolute or relative ownership levels. It could occur, for example, when an associate becomes subject to the control of another government, a court, administrator or regulator. It could also occur as a result of a binding agreement.

#### **Equity Method**

17. Under the equity method, the investment in an associate is initially recognized at cost and the carrying amount is increased or decreased to recognize the investor's share of surplus or deficit of the investee after the date of acquisition. The investor's share of the surplus or deficit of the investee is recognized in the investor's surplus or deficit. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been recognized in the investee's surplus or deficit. Such changes include those arising from the revaluation of property, plant, equipment and from foreign exchange translation differences. The investor's share of those changes is recognized directly in net assets/equity of the investor.
18. When potential voting rights exist, the investor's share of surplus or deficit of the investee and of changes in the investee's net assets/equity is determined

on the basis of present ownership interests and does not reflect the possible exercise or conversion of potential voting rights.

### **Application of the Equity Method**

19. **An investment in an associate shall be accounted for using the equity method except when:**
- (a) **There is evidence that the investment is acquired and held exclusively with a view to its disposal within twelve months from acquisition and that management is actively seeking a buyer;**
  - (b) **The exception in paragraph 16 of IPSAS 6, allowing a controlling entity that also has an investment in an associate not to present consolidated financial statements, applies; or**
  - (c) **All of the following apply:**
    - (i) **The investor is:**
      - **A wholly-owned controlled entity and users of financial statements prepared by applying the equity method are unlikely to exist or their information needs are met by the controlling entity's consolidated financial statements; or**
      - **A partially-owned controlled entity of another entity and its other owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the investor not applying the equity method;**
    - (ii) **The investor's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);**
    - (iii) **The investor did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization, for the purpose of issuing any class of instruments in a public market; and**
    - (iv) **The ultimate or any intermediate controlling entity of the investor produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.**
20. **Investments described in paragraph 19(a) shall be classified as held for trading and accounted for in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.**

21. When an investment in an associate previously accounted for in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments is not disposed of within twelve months, it shall be accounted for using the equity method as from the date of acquisition. Financial statements for the periods since acquisition shall be restated.
22. Exceptionally, an entity may have found a buyer for an associate described in paragraph 19(a), but may not have completed the sale within twelve months because of the need for approval by regulators or others. The entity is not required to apply the equity method to an investment in such an associate if the sale is in process at the reporting date and there is no reason to believe that it will not be completed shortly after the reporting date.
23. The recognition of revenue on the basis of distributions received may not be an adequate measure of the revenue earned by an investor on an investment in an associate because the distributions received may bear little relation to the performance of the associate. In particular, where the associate has not-for-profit objectives, investment performance will be determined by factors such as the cost of outputs and overall service delivery. Because the investor has significant influence over the associate, the investor has an interest in the associate's performance and, as a result, the return on its investment. The investor accounts for this interest by extending the scope of its financial statements to include its share of surpluses or deficits of such an associate. As a result, application of the equity method provides more informative reporting of the net assets/equity and surplus or deficit of the investor.
24. **An investor shall discontinue the use of the equity method from the date that it ceases to have significant influence over an associate and shall account for the investment in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments from that date, provided the associate does not become a controlled entity or a joint venture as defined in IPSAS 8.**
25. **The carrying amount of the investment at the date that it ceases to be an associate shall be regarded as its cost on initial measurement as a financial asset in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.**
26. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures described in IPSAS 6. Furthermore, the concepts underlying the procedures used in accounting for the acquisition of a controlled entity are also adopted in accounting for the acquisition of an investment in an associate.

27. An economic entity's share in an associate is the aggregate of the holdings in that associate by the controlling entity and its controlled entities. The holdings of the economic entity's other associates or joint ventures are ignored for this purpose. When an associate has controlled entities, associates or joint ventures, the surpluses or deficits and net assets taken into account in applying the equity method are those recognized in the associate's financial statements (including the associate's share of the surpluses or deficits and net assets of its associates and joint ventures), after any adjustments necessary to give effect to uniform accounting policies (see paragraphs 32 and 33).
28. Surpluses and deficits resulting from upstream and downstream transactions between an investor (including its consolidated controlled entities) and an associate are recognized in the investor's financial statements only to the extent of unrelated investors' interests in the associate. Upstream transactions are, for example, sales of assets from an associate to the investor. Downstream transactions are, for example, sales of assets from the investor to an associate. The investor's share in the associate's surpluses and deficits resulting from these transactions is eliminated.
29. An investment in an associate is accounted for using the equity method from the date on which it becomes an associate. Guidance on accounting for any difference (whether positive or negative) between the cost of acquisition and the investor's share of the fair values of the net identifiable assets of the associate is treated as goodwill (guidance can be found in the relevant international or national accounting standard dealing with business combinations). Goodwill relating to an associate is included in the carrying amount of the investment. Appropriate adjustments to the investor's share of the surpluses or deficits after acquisition are made to account, for example, for depreciation of the depreciable assets, based on their fair values at the date of acquisition.
30. **The most recent available financial statements of the associate are used by the investor in applying the equity method. When the reporting dates of the investor and the associate are different, the associate prepares, for the use of the investor, financial statements as of the same date as the financial statements of the investor unless it is impracticable to do so.**
31. **When, in accordance with paragraph 30, the financial statements of an associate used in applying the equity method are prepared as of a different reporting date from that of the investor, adjustments shall be made for the effects of significant transactions or events that occur between that date and the date of the investor's financial statements. In any case, the difference between the reporting date of the associate and that of the investor shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.**

32. **The investor's financial statements shall be prepared using uniform accounting policies for like transactions and events in similar circumstances.**
33. If an associate uses accounting policies other than those of the investor for like transactions and events in similar circumstances, adjustments shall be made to conform the associate's accounting policies to those of the investor when the associate's financial statements are used by the investor in applying the equity method.
34. If an associate has outstanding cumulative preferred shares that are held by parties other than the investor and classified as net assets/equity, the investor computes its share of surpluses or deficits after adjusting for the dividends on such shares, whether or not the dividends have been declared.
35. If an investor's share of deficits of an associate equals or exceeds its interest in the associate, the investor discontinues recognizing its share of further losses. The interest in an associate is the carrying amount of the investment in the associate under the equity method together with any long-term interests that, in substance, form part of the investor's net investment in the associate. For example, an item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, an extension of the entity's investment in that associate. Such items may include preference shares and long-term receivables or loans but do not include trade receivables, trade payables or any long-term receivables for which adequate collateral exists, such as secured loans. Losses recognized under the equity method in excess of the investor's investment in ordinary shares are applied to the other components of the investor's interest in an associate in the reverse order of their seniority (i.e., priority of liquidation).
36. After the investor's interest is reduced to zero, additional losses are provided for, and a liability is recognized, only to the extent that the investor has incurred legal or constructive obligations or made payments on behalf of the associate. If the associate subsequently reports surpluses, the investor resumes recognizing its share of those surpluses only after its share of the surpluses equals the share of deficits not recognized.

#### **Impairment Losses**

37. After application of the equity method, including recognizing the associate's losses in accordance with paragraph 35, the investor applies the requirements of the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments to determine whether it is necessary to recognize any additional impairment loss with respect to the investor's net investment in the associate.
38. The investor also applies the requirements of the relevant international or national accounting standard dealing with the recognition and measurement of

financial instruments to determine whether any additional impairment loss is recognized with respect to the investor's interest in the associate that does not constitute part of the net investment and the amount of the impairment loss.

39. If application of the requirements in the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments indicates that the investment may be impaired, an entity applies IPSAS 21, "Impairment of Non-Cash Generating Assets." IPSAS 21 directs an entity to refer IAS 36 to determine the value in use of the cash-generating investment. Based on IAS 36, an entity estimates:
- (a) Its share of the present value of the estimated future cash flows expected to be generated by the investee, including the cash flows from the operations of the investee and the proceeds on the ultimate disposal of the investment; or
  - (b) The present value of the estimated future cash flows expected to arise from dividends or similar distributions to be received from the investment and from its ultimate disposal.

Under appropriate assumptions, both methods give the same result. Any resulting impairment loss for the investment is allocated in accordance with IAS 36. Therefore, it is allocated first to any remaining goodwill (see paragraph 29).

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

### Separate Financial Statements

41. **An investment in an associate shall be accounted for in the investor's separate financial statements in accordance with paragraphs 58-64 of IPSAS 6.**
42. This Standard does not mandate which entities produce separate financial statements available for public use.

### Disclosure

43. **The following disclosures shall be made:**
- (a) **The fair value of investments in associates for which there are published price quotations;**
  - (b) **Summarized financial information of associates, including the aggregated amounts of assets, liabilities, revenues and surplus or deficit;**
  - (c) **The reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or**

- indirectly through controlled entities, less than 20 percent of the voting or potential voting power of the investee but concludes that it has significant influence;
- (d) The reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through controlled entities, 20 percent or more of the voting power of the investee but concludes that it does not have significant influence;
  - (e) The reporting date of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a reporting date or for a period that is different from that of the investor, and the reason for using a different reporting date or different period;
  - (f) The nature and extent of any significant restrictions (e.g., resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or similar distributions, or repayment of loans or advances;
  - (g) The unrecognized share of losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate;
  - (h) The fact that an associate is not accounted for using the equity method in accordance with paragraph 19; and
  - (i) Summarized financial information of associates, either individually or in groups, that are not accounted for using the equity method, including the amounts of total assets, total liabilities, revenues and surpluses or deficits.
44. Investments in associates accounted for using the equity method shall be classified as non-current assets. The investor's share of the surplus or deficit of such associates, and the carrying amount of these investments shall be separately disclosed. The investor's share of any discontinuing operations of such associates shall also be separately disclosed.
45. The investor's share of changes recognized directly in the associate's net assets/equity shall be recognized directly in net assets/equity by the investor and shall be disclosed in the statement of changes in net assets/equity as required by International Public Sector Accounting Standard IPSAS 1, "Presentation of Financial Statements."
46. In accordance with IPSAS 19, "Provisions, Contingent Liability and Contingent Assets," the investor shall disclose:

- (a) **Its share of the contingent liabilities of an associate incurred jointly with other investors; and**
- (b) **Those contingent liabilities that arise because the investor is severally liable for all or part of the liabilities of the associate.**

### **Effective Date**

- 47. **An entity shall apply this International Public Sector Accounting Standard for annual periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
- 48. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

### **Withdrawal of IPSAS 7 (2000)**

- 49. This Standard supersedes IPSAS 7, "Accounting for Investments in Associates" issued in 2000.

**Appendix****Amendments to Other Pronouncements**

*The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after DD MM YYY. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.*

In International Public Sector Accounting Standards, applicable at MM YYY, references to the current version of IPSAS 7, “Accounting for Investments in Associates” are amended to IPSAS 7, “Investments in Associates.”

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the proposed International Public Sector Accounting Standards. This Basis for Conclusions only notes the IPSASB's reasons for departing from provisions of the related International Accounting Standard.*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)'s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS is not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the "comparison with IFRS" included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 7, issued in May 2000 was based on IAS 28 (Reformatted 1994), "Accounting for Investments in Associates" which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 28 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The

<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

IASB's Bases for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)).

- BC6. IAS 28 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 7 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

### Comparison with IAS 28

IPSAS 7, “Investments in Associates” (Revised 2003) is drawn primarily from IAS 28, “Investments in Associates” (Revised 2003). At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 3, “Business Combinations” and IFRS 5, “Non-current Assets Held for Sale and Discontinued Operations” to public sector entities. Therefore, IPSAS 7 does not reflect amendments made to IAS 27 consequent upon the issue of those Standards. The main differences between IPSAS 7 and IAS 28 are as follows:

- Commentary additional to that in IAS 28 has been included in IPSAS 7 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 7 applies to all investments in associates where the investor holds an ownership interest in the associate in the form of a shareholding or other formal equity structure. IAS 28 does not contain similar ownership interest requirements. However, it is unlikely that equity accounting could be applied unless the associate had a formal or other reliably measurable equity structure.
- IPSAS 7 uses different terminology, in certain instances, from IAS 28. The most significant examples are the use of the terms statement of financial performance, statement of financial position and net assets/equity in IPSAS 7. The equivalent terms in IAS 28 are income statement, balance sheet and equity.
- IPSAS 7 does not use the term income, which in IAS 28 has a broader meaning than the term revenue.
- IPSAS 7 contains a different set of definitions of technical terms from IAS 28 (paragraph 7).

## **IPSAS 8—INTERESTS IN JOINT VENTURES**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 31 (Revised 2003), “Interests in Joint Ventures” published by the International Accounting Standards Board (IASB). Extracts from IAS 31 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of International Accounting Standards Committee Foundation (IASCF).

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International Public Sector Accounting Standard 8, “Interests in Joint Ventures” (IPSAS 8) is set out in paragraphs 1-71 and the Appendix. All the paragraphs have equal authority. IPSAS 8 should be read in the context of the Basis for Conclusion (if any), and the “Preface to International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

IN1. International Public Sector Accounting Standard (IPSAS) 8, “Interests in Joint Ventures,” replaces IPSAS 8, “Financial Reporting of Interests in Joint Ventures” (issued May 2000), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## Reasons for Revising IPSAS 8

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 8 as a response to the International Accounting Standards Board’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 8, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 31, “Financial Reporting of Interests in Joint Ventures” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 31 for a public sector specific reason; such variances are retained in this IPSAS 8 and are noted in the Comparison with IAS 31. Any changes to IAS 31 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 8.

## Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 8 are described below.

## Title of the Standard

IN5. The title of the Standard is changed to “Interests in Joint Ventures.”

## Scope

IN6. The Standard excludes from the scope in paragraph 1, venturers’ interests in jointly controlled entities that are recognized at fair value held by:

- Venture capital organizations; or
- Mutual funds, unit trusts and similar entities including investment-linked insurance funds.

Previously, IPSAS 8 did not contain these exclusions from its scope.

## Definitions

IN7. The Standard in paragraph 6:

- Includes a definition of a new term: separate financial statements.

- Does not include the following unnecessary terms: accrual basis, assets, associates, cash, cash flows, contribution from owners, controlled entity, controlling entity, distribution to owners, economic entity, expenses, government business enterprises, liabilities, net assets/equity, and revenue. These terms are defined in other IPSASs.
- Does not include the term net surplus/deficit, which no longer exists.

IN8. The Standard includes in paragraphs 14–16 explanation of separate financial statements. Previously, IPSAS 8 did not contain these illustrations.

### **Exemptions from Applying Proportionate Consolidation or the Equity Method**

IN9. The Standard clarifies in paragraphs 47 and paragraph 3(a) that applying proportionate consolidation or the equity method is not required when (a) an interest in a joint venture is acquired and held exclusively with a view to its disposal within twelve months from acquisition and (b) management is actively seeking a buyer.

IN10. IPSAS 8 further specifies in paragraph 49 that when a jointly controlled entity previously exempted from proportionate consolidation or the equity method is not disposed of within twelve months, it shall be accounted for using proportionate consolidation or the equity method from the date of acquisition unless narrowly specified circumstances apply.

IN11. The words “in the near future” used in previous IPSAS 8 have been replaced with the words “within twelve months.” There was no requirement that management must be actively seeking a buyer in previous IPSAS 8 for exemption from applying proportionate consolidation or the equity method.

IN12. The Standard clarifies in paragraph 3(b) and 3(c) the exemptions from application of proportionate consolidation or the equity method, including when the venturer is:

- Also a controlling entity exempt in accordance with IPSAS 6, “Consolidated and Separate Financial Statements” from preparing consolidated financial statements; or
- Though not such a controlling entity, can satisfy the same type of conditions that exempt such controlling entities.

IN13. IPSAS 6 requires that a controlling entity need not present consolidated financial statements if and only if:

- The controlling entity is itself a wholly-owned controlled entity and users of such financial statements are unlikely to exist or their information needs are met by its controlling entity’s consolidated financial statements; or is a partially-owned controlled entity of another entity and its other owners, including those not otherwise

entitled to vote, have been informed about, and do not object to, the controlling entity not presenting consolidated financial statements;

- The controlling entity's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
- The controlling entity did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization for the purpose of issuing any class of instruments in a public market; and
- The ultimate or any intermediate controlling entity of the controlling entity produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.

Previously, IPSAS 8 did not contain these exemptions.

IN14. The Standard does not include the previous paragraph 46(b) clarifying that severe long-term restrictions that significantly impair the ability to transfer funds to the venturer do not of themselves justify not applying the proportionate consolidation or the equity method. Joint control must be lost before proportionate consolidation or the equity method ceases to apply.

### **Separate Financial Statements**

IN15. The Standard requires in paragraph 52 that a venturer should account for an interest in a jointly controlled entity in its separate financial statements in accordance with IPSAS 6. IPSAS 6 requires that the venturer shall account for its interest in a jointly controlled entity in its separate financial statements either at cost or as financial instruments in accordance with the relevant international or national accounting standard dealing with financial instruments.

### **Disclosure**

IN16. The Standard requires in paragraph 64 that a venturer shall disclose the method it uses to recognize its interests in jointly controlled entities (i.e., proportionate consolidation or the equity method).

### **Amendments to Other IPSASs**

IN17. The Standard includes an authoritative appendix of amendments to other IPSASs.

**IPSAS 8—INTERESTS IN JOINT VENTURES****Scope**

1. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, revenue and expenses in the financial statements of venturers and investors, regardless of the structures or forms under which the joint venture activities take place. However, it does not apply to venturers' interests in jointly controlled entities held by:**
  - (a) **Venture capital organizations; or**
  - (b) **Mutual funds, unit trusts and similar entities including investment-linked insurance funds**

**that are measured at fair value, with changes in fair value recognized in surplus or deficit in the period of the change in accordance with the relevant international or national accounting standard dealing with the recognition and measurement of financial instruments.**
2. Guidance on recognition and measurement of interests identified in paragraph 1 that are measured at fair value, with changes in fair value recognized in surplus or deficit in the period of the change can be found in the relevant international or national accounting standard dealing with financial instruments.
3. **A venturer with an interest in a jointly controlled entity is exempted from paragraphs 35 (proportionate consolidation) and 43 (equity method) when it meets the following conditions:**
  - (a) **There is evidence that the interest is acquired and held exclusively with a view to its disposal within twelve months from acquisition and that management is actively seeking a buyer;**
  - (b) **The exception in paragraph 16 of IPSAS 6, "Consolidated and Separate Financial Statements" allowing a controlling entity that also has an interest in a jointly controlled entity not to present consolidated financial statements is applicable; or**
  - (c) **All of the following apply:**
    - (i) **The venturer is:**
      - **A wholly-owned controlled entity and users of financial statements prepared by applying proportionate consolidation or the equity method are unlikely to exist or their information needs are met by**

- the controlling entity's consolidated financial statements; or
- A partially-owned controlled entity of another entity and its owners, including those not otherwise entitled to vote, have been informed about, and do not object to, the venturer not applying proportionate consolidation or the equity method;
- (ii) The venturer's debt or equity instruments are not traded in a public market (a domestic or foreign stock exchange or an over-the-counter market, including local and regional markets);
  - (iii) The venturer did not file, nor is it in the process of filing, its financial statements with a securities commission or other regulatory organization, for the purpose of issuing any class of instruments in a public market; and
  - (iv) The ultimate or any intermediate controlling entity of the venturer produces consolidated financial statements available for public use that comply with International Public Sector Accounting Standards.
4. **This Standard applies to all public sector entities other than Government Business Enterprises.**
  5. The "Preface to International Public Sector Accounting Standards" issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, "Presentation of Financial Statements."

### Definitions

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

**Consolidated financial statements** are the financial statements of an economic entity presented as those of a single entity.

**Control** is the power to govern the financial and operating policies of another entity so as to benefit from its activities.

The **equity method** (for the purpose of this Standard) is a method of accounting whereby an interest in a jointly controlled entity is initially recorded at cost and adjusted thereafter for the post-acquisition change in the venturer's share of net assets/equity of the jointly controlled entity.

The surplus or deficit of the venturer includes the venturer's share of the surplus or deficit of the jointly controlled entity.

**Investor in a joint venture** is a party to a joint venture and does not have joint control over that joint venture.

**Joint control** is the agreed sharing of control over an activity by a binding arrangement.

**Joint venture** is a binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.

**Proportionate consolidation** is a method of accounting whereby a venturer's share of each of the assets, liabilities, revenue and expenses of a jointly controlled entity is combined line by line with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.

**Separate financial statements** are those presented by a controlling entity, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.

**Significant influence** (for the purpose of this Standard) is the power to participate in the financial and operating policy decisions of an activity but is not control or joint control over those policies.

**Venturer** is a party to a joint venture and has joint control over that joint venture.

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

### **Binding Arrangement**

7. The existence of a binding arrangement distinguishes interests that involve joint control from investments in associates in which the investor has significant influence (see International Public Sector Accounting Standard (IPSAS) 7, "Investments in Associates"). For the purposes of this Standard, an arrangement includes all binding arrangements between venturers. That is, in substance, the arrangement confers similar rights and obligations on the parties to it as if it were in the form of a contract. For instance, two government departments may enter into a formal arrangement to undertake a joint venture but the arrangement may not constitute a legal contract because, in that jurisdiction, individual departments may not be separate legal entities

with the power to contract. Activities that have no binding arrangement to establish joint control are not joint ventures for the purposes of this Standard.

8. The binding arrangement may be evidenced in a number of ways, for example by a contract between the venturers or minutes of discussions between the venturers. In some cases, the binding arrangement is incorporated in the enabling legislation, articles or other by-laws of the joint venture. Whatever its form, the arrangement is usually in writing and deals with such matters as:
  - (a) The activity, duration and reporting obligations of the joint venture;
  - (b) The appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers;
  - (c) Capital contributions by the venturers; and
  - (d) The sharing by the venturers of the output, revenue, expenses, surpluses or deficits, or cash flows of the joint venture.
9. The binding arrangement establishes joint control over the joint venture. Such a requirement ensures that no single venturer is in a position to control the activity unilaterally. The arrangement identifies those decisions in areas essential to the goals of the joint venture which require the consent of all the venturers and those decisions which may require the consent of a specified majority of the venturers.
10. The binding arrangement may identify one venturer as the operator or manager of the joint venture. The operator does not control the joint venture but acts within the financial and operating policies that have been agreed by the venturers in accordance with the arrangement and delegated to the operator. If the operator has the power to govern the financial and operating policies of the activity, it controls the venture and the venture is a controlled entity of the operator and not a joint venture.

### **Forms of Joint Venture**

11. Many public sector entities establish joint ventures to undertake a variety of activities. The nature of these activities ranges from commercial undertakings to provision of community services at no charge. The terms of a joint venture are set out in a contract or other binding arrangement and usually specify the initial contribution from each joint venturer and the share of revenues or other benefits (if any), and expenses of each of the joint venturers.
12. Joint ventures take many different forms and structures. This Standard identifies three broad types—jointly controlled operations, jointly controlled assets and jointly controlled entities—that are commonly described as, and meet the definition of, joint ventures. The following characteristics are common to all joint ventures:
  - (a) Two or more venturers are bound by a binding arrangement; and

- (b) The binding arrangement establishes joint control.

### **Joint Control**

13. Joint control may be precluded when a joint venture is in legal reorganization or in bankruptcy, is subject to an administrative restructuring of government arrangements, or operates under severe long-term restrictions on its ability to transfer funds to the venturer. If joint control is continuing, these events are not enough in themselves to justify not accounting for joint ventures in accordance with this Standard.

### **Separate Financial Statements**

14. Financial statements in which proportionate consolidation or the equity method is applied are not separate financial statements, nor are the financial statements of an entity that does not have a controlled entity, associate or venturer's interest in a jointly controlled entity.
15. Separate financial statements are those presented in addition to consolidated financial statements, financial statements in which investments are accounted for using the equity method and financial statements in which venturers' interests in joint ventures are proportionately consolidated. Separate financial statements need not be appended to, or accompany, those statements.
16. Entities that are exempted in accordance with paragraph 16 of IPSAS 6 from consolidation, paragraph 19(c) of IPSAS 7, "Investments in Associates" from applying the equity method or paragraph 3 of this Standard from applying proportionate consolidation or the equity method may present separate financial statements as their only financial statements.

### **Jointly Controlled Operations**

17. The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own property, plant and equipment and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides a means by which the revenue from the sale or provision of the joint product or service and any expenses incurred in common are shared among the venturers.
18. An example of a jointly controlled operation is when two or more venturers combine their operations, resources and expertise to manufacture, market and distribute jointly a particular product, such as an aircraft. Different parts of the manufacturing process are carried out by each of the venturers. Each venturer bears its own costs and takes a share of the revenue from the sale of

the aircraft, such share being determined in accordance with the binding arrangement. A further example is when two entities combine their operations, resources and expertise to jointly deliver a service, such as aged care where, in accordance with an agreement, a local government offers domestic services and a local hospital offers medical care. Each venturer bears its own costs and takes a share of revenue, such as user charges and government grants; such share being determined in accordance with the binding agreement.

19. **In respect of its interests in jointly controlled operations, a venturer shall recognize in its financial statements:**
  - (a) **The assets that it controls and the liabilities that it incurs; and**
  - (b) **The expenses that it incurs and its share of the revenue that it earns from the sale or provision of goods or services by the joint venture.**
20. Because the assets, liabilities, revenue (if any) and expenses are already recognized in the financial statements of the venturer, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.
21. Separate accounting records may not be required for the joint venture itself and financial statements may not be prepared for the joint venture. However, the venturers may prepare management accounts so that they may assess the performance of the joint venture.

### **Jointly Controlled Assets**

22. Some joint ventures involve the joint control, and often the joint ownership by, the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture. The assets are used to obtain benefits for the venturers. Each venturer may take a share of the output from the assets and each bears an agreed share of the expenses incurred.
23. These joint ventures do not involve the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer has control over its share of future economic benefits or service potential through its share of the jointly controlled asset.
24. Some activities in the public sector involve jointly controlled assets. For example, a local government may enter into an arrangement with a private sector corporation to construct a toll road. The road provides the citizens with improved access between the local government's industrial estate and its port facilities. The road also provides the private sector corporation with direct access between its manufacturing plant and the port. The agreement between

the local authority and the private sector corporation specifies each party's share of revenues and expenses associated with the toll road. Accordingly, each venturer derives economic benefits or service potential from the jointly controlled asset and bears an agreed proportion of the costs of operating the road. Similarly, many activities in the oil, gas and mineral extraction industries involve jointly controlled assets. For example, a number of oil production companies may jointly control and operate an oil pipeline. Each venturer uses the pipeline to transport its own product in return for which it bears an agreed proportion of the expenses of operating the pipeline. Another example of a jointly controlled asset is when two entities jointly control a property, each taking a share of the rents received and bearing a share of the expenses.

25. **In respect of its interest in jointly controlled assets, a venturer shall recognize in its financial statements:**
- (a) **Its share of the jointly controlled assets, classified according to the nature of the assets;**
  - (b) **Any liabilities that it has incurred;**
  - (c) **Its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;**
  - (d) **Any revenue from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and**
  - (e) **Any expenses that it has incurred in respect of its interest in the joint venture.**
26. In respect of its interest in jointly controlled assets, each venturer includes in its accounting records and recognizes in its financial statements:
- (a) Its share of the jointly controlled assets, classified according to the nature of the assets rather than as an investment. For example, a share of a jointly controlled road is classified as property, plant and equipment.
  - (b) Any liabilities that it has incurred, for example those incurred in financing its share of the assets.
  - (c) Its share of any liabilities incurred jointly with other venturers in relation to the joint venture.
  - (d) Any revenue from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture.
  - (e) Any expenses that it has incurred in respect of its interest in the joint venture, for example those related to financing the venturer's interest in the assets and selling its share of the output.

27. Because the assets, liabilities, revenue and expenses are recognized in the financial statements of the venturer, no adjustments or other consolidation procedures are required in respect of these items when the venturer presents consolidated financial statements.
28. The treatment of jointly controlled assets reflects the substance and economic reality and, usually, the legal form of the joint venture. Separate accounting records for the joint venture itself may be limited to those expenses incurred in common by the venturers and ultimately borne by the venturers according to their agreed shares. Financial statements may not be prepared for the joint venture, although the venturers may prepare management accounts so that they may assess the performance of the joint venture.

### **Jointly Controlled Entities**

29. A jointly controlled entity is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a binding arrangement between the venturers establishes joint control over the activity of the entity.
30. A jointly controlled entity controls the assets of the joint venture, incurs liabilities and expenses and earns revenue. It may enter into contracts in its own name and raise finance for the purposes of the joint venture activity. Each venturer is entitled to a share of the surpluses of the jointly controlled entity, although some jointly controlled entities also involve a sharing of the output of the joint venture.
31. A common example of a jointly controlled entity is when two entities combine their activities in a particular line of service delivery by transferring the relevant assets and liabilities into a jointly controlled entity. Another example arises when an entity commences a business in a foreign country in conjunction with a government or other agency in that country, by establishing a separate entity that is jointly controlled by the entity and the government or agency in the foreign country.
32. Many jointly controlled entities are similar in substance to those joint ventures referred to as jointly controlled operations or jointly controlled assets. For example, the venturers may transfer a jointly controlled asset, such as a road, into a jointly controlled entity, for tax or other reasons. Similarly, the venturers may contribute into a jointly controlled entity assets that will be operated jointly. Some jointly controlled operations also involve the establishment of a jointly controlled entity to deal with particular aspects of the activity, for example, the design, marketing, distribution or after-sales service of the product.
33. A jointly controlled entity maintains its own accounting records and prepares and presents financial statements in the same way as other entities in

conformity with International Public Sector Accounting Standards or other accounting standards if appropriate.

34. Each venturer usually contributes cash or other resources to the jointly controlled entity. These contributions are included in the accounting records of the venturer and recognized in its financial statements as an investment in the jointly controlled entity.

## **Financial Statements of a Venturer**

### *Proportionate Consolidation*

35. **A venturer shall recognize its interest in a jointly controlled entity using proportionate consolidation or the alternative method described in paragraph 43. When proportionate consolidation is used, one of the two reporting formats identified below shall be used.**
36. A venturer recognizes its interest in a jointly controlled entity using one of the two reporting formats for proportionate consolidation irrespective of whether it also has investments in controlled entities or whether it describes its financial statements as consolidated financial statements.
37. When recognizing an interest in a jointly controlled entity, it is essential that a venturer reflects the substance and economic reality of the arrangement, rather than the joint venture's particular structure or form. In a jointly controlled entity, a venturer has control over its share of future economic benefits or service potential through its share of the assets and liabilities of the venture. This substance and economic reality are reflected in the consolidated financial statements of the venturer when the venturer recognizes its interests in the assets, liabilities, revenue and expenses of the jointly controlled entity by using one of the two reporting formats for proportionate consolidation described in paragraph 39.
38. The application of proportionate consolidation means that the statement of financial position of the venturer includes its share of the assets that it controls jointly and its share of the liabilities for which it is jointly responsible. The statement of financial performance of the venturer includes its share of the revenue and expenses of the jointly controlled entity. Many of the procedures appropriate for the application of proportionate consolidation are similar to the procedures for the consolidation of investments in controlled entities, which are set out in IPSAS 6.
39. Different reporting formats may be used to give effect to proportionate consolidation. The venturer may combine its share of each of the assets, liabilities, revenue and expenses of the jointly controlled entity with the similar items, line by line, in its financial statements. For example, it may combine its share of the jointly controlled entity's inventory with its inventory and its share of the jointly controlled entity's property, plant and equipment

with its property, plant and equipment. Alternatively, the venturer may include separate line items for its share of the assets, liabilities, revenue and expenses of the jointly controlled entity in its financial statements. For example, it may show its share of a current asset of the jointly controlled entity separately as part of its current assets; it may show its share of the property, plant and equipment of the jointly controlled entity separately as part of its property, plant and equipment. Both these reporting formats result in the reporting of identical amounts of surplus or deficit and of each major classification of assets, liabilities, revenue and expenses; both formats are acceptable for the purposes of this Standard.

40. Whichever format is used to give effect to proportionate consolidation, it is inappropriate to offset any assets or liabilities by the deduction of other liabilities or assets or any revenue or expenses by the deduction of other expenses or revenue, unless a legal right of set-off exists and the offsetting represents the expectation as to the realization of the asset or the settlement of the liability.
41. **A venturer shall discontinue the use of proportionate consolidation from the date on which it ceases to have joint control over a jointly controlled entity.**
42. A venturer discontinues the use of proportionate consolidation from the date on which it ceases to share in the control of a jointly controlled entity. This may happen, for example, when the venturer disposes of its interest or when such external restrictions are placed on the jointly controlled entity that the venturer no longer has joint control.

#### *Equity Method*

43. **As an alternative to proportionate consolidation described in paragraph 35, a venturer shall recognize its interest in a jointly controlled entity using the equity method.**
44. A venturer recognizes its interest in a jointly controlled entity using the equity method irrespective of whether it also has investments in controlled entities or whether it describes its financial statements as consolidated financial statements.
45. Some venturers recognize their interests in jointly controlled entities using the equity method, as described in IPSAS 7. The use of the equity method is supported by those who argue that it is inappropriate to combine controlled items with jointly controlled items and by those who believe that venturers have significant influence, rather than joint control, in a jointly controlled entity. This Standard does not recommend the use of the equity method because proportionate consolidation better reflects the substance and economic reality of a venturer's interest in a jointly controlled entity, that is to say, control over the venturer's share of the future economic benefits or service potential.

Nevertheless, this Standard permits the use of the equity method, as an alternative treatment, when recognizing interests in jointly controlled entities.

46. **A venturer shall discontinue the use of the equity method from the date on which it ceases to have joint control over, or have significant influence in, a jointly controlled entity.**

*Exceptions to Proportionate Consolidation and Equity Method*

47. **Interests in jointly controlled entities for which there is evidence that the interest is acquired and held exclusively with a view to its disposal within twelve months from acquisition and that management is actively seeking a buyer, as set out in paragraph 3(a), shall be classified and accounted for as held for trading financial instruments in accordance with the relevant international or national accounting standard dealing with financial instruments.**
48. Guidance on the recognition and measurement of financial instruments dealt with in paragraph 47 can be found in the relevant international or national accounting standard dealing with financial instruments.
49. When, in accordance with paragraphs 3(a) and 47, an interest in a jointly controlled entity previously accounted for as a held for trading financial instrument is not disposed of within twelve months, it shall be accounted for using proportionate consolidation or the equity method as from the date of acquisition. (Guidance on the meaning of the date of acquisition can be found in the relevant international or national accounting standard dealing with business combinations.) Financial statements for the periods since acquisition shall be restated.
50. Exceptionally, a venturer may have found a buyer for an interest described in paragraphs 3(a) and 47, but may not have completed the sale within twelve months of acquisition because of the need for approval by regulators or others. The venturer is not required to apply proportionate consolidation or the equity method to an interest in a jointly controlled entity if the sale is in process at the reporting date and there is no reason to believe that it will not be completed shortly after the reporting date.
51. **From the date on which a jointly controlled entity becomes a controlled entity of a venturer, the venturer shall account for its interest in accordance with IPSAS 6. From the date on which a jointly controlled entity becomes an associate of a venturer, the venturer shall account for its interest in accordance with IPSAS 7.**

**Separate Financial Statements of a Venturer**

52. **An interest in a jointly controlled entity shall be accounted for in a venturer's separate financial statements in accordance with paragraphs 58-64 of IPSAS 6.**

53. This Standard does not mandate which entities produce separate financial statements available for public use.

### **Transactions between a Venturer and a Joint Venture**

54. **When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks and rewards of ownership, the venturer shall recognize only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer shall recognize the full amount of any loss when the contribution or sale provides evidence of a reduction in the net realizable value of current assets or an impairment loss.**
55. **When a venturer purchases assets from a joint venture, the venturer shall not recognize its share of the gains of the joint venture from the transaction until it resells the assets to an independent party. A venturer shall recognize its share of the losses resulting from these transactions in the same way as gains except that losses shall be recognized immediately when they represent a reduction in the net realizable value of current assets or an impairment loss.**
56. To assess whether a transaction between a venturer and a joint venture provides evidence of impairment of an asset, the venturer determines the recoverable amount or recoverable service amount of the assets in accordance with IPSAS 21, "Impairment of Non-Cash-Generating Assets." In determining value in use of a cash-generating asset, the venturer estimates future cash flows from the asset on the basis of continuing use of the asset and its ultimate disposal by the joint venture. In determining value in use of a non-cash-generating asset, the venturer estimates the present value of the remaining service potential of the asset using the approaches specified in IPSAS 21.

### **Reporting Interests in Joint Ventures in the Financial Statements of an Investor**

57. **An investor in a joint venture that does not have joint control, but does have significant influence shall account for its interest in a joint venture in accordance with IPSAS 7.**
58. Guidance on accounting for interests in joint ventures where an investor does not have joint control or significant influence can be found in the relevant international or national accounting standard dealing with financial instruments.

## Operators of Joint Ventures

59. **Operators or managers of a joint venture shall account for any fees in accordance with IPSAS 9, “Revenue from Exchange Transactions.”**
60. One or more venturers may act as the operator or manager of a joint venture. Operators are usually paid a management fee for such duties. The fees are accounted for by the joint venture as an expense.

## Disclosure

61. **A venturer shall disclose:**
- (a) **The aggregate amount of the following contingent liabilities, unless the possibility of any outflow in settlement is remote, separately from the amount of other contingent liabilities:**
    - (i) **Any contingent liabilities that the venturer has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities that have been incurred jointly with other venturers;**
    - (ii) **Its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and**
    - (iii) **Those contingent liabilities that arise because the venturer is contingently liable for the liabilities of the other venturers of a joint venture; and**
  - (b) **A brief description of the following contingent assets and, where practicable, an estimate of their financial effect, where an inflow of economic benefits or service potential is probable:**
    - (i) **Any contingent assets of the venturer arising in relation to its interests in joint ventures and its share in each of the contingent assets that have arisen jointly with other venturers; and**
    - (ii) **Its share of the contingent assets of the joint ventures themselves.**
62. **A venturer shall disclose the aggregate amount of the following commitments in respect of its interests in joint ventures separately from other commitments:**
- (a) **Any capital commitments of the venturer in relation to its interests in joint ventures and its share in the capital commitments that have been incurred jointly with other venturers; and**
  - (b) **Its share of the capital commitments of the joint ventures themselves.**

63. **A venturer shall disclose a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities. A venturer that recognizes its interests in jointly controlled entities using the line-by-line reporting format for proportionate consolidation or the equity method shall disclose the aggregate amounts of each of current assets, non-current assets, current liabilities, non-current liabilities, revenue and expenses related to its interest in joint ventures.**
64. **A venturer shall disclose the method it uses to recognize its interests in jointly controlled entities.**

### **Transitional Provisions**

65. **Where the proportionate consolidation treatment set out in this Standard is adopted, venturers are not required to eliminate balances and transactions between themselves, their controlled entities and entities that they jointly control for reporting periods beginning on a date within three years following the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards.**
66. Entities that adopt accrual accounting for the first time in accordance with International Public Sector Accounting Standards may have many controlled and jointly controlled entities with a significant number of transactions between these entities. Accordingly, it may initially be difficult to identify all the transactions and balances that need to be eliminated for the purpose of preparing the financial statements. For this reason, paragraph 65 provides temporary relief from eliminating in full balances and transactions between entities and their jointly controlled entities.
67. **Where entities apply the transitional provision in paragraph 65, they shall disclose the fact that not all inter-entity balances and transactions have been eliminated.**
68. Transitional provisions in IPSAS 8 (2000) provide entities with a period of up to three years to fully eliminate balances and transactions between entities within the economic entity from the date of its first application. Entities that have previously applied IPSAS 8 (2000) may continue to take advantage of this three-year transitional provisional period from the date of first application of IPSAS 8 (2000).

### **Effective Date**

69. **An entity shall apply this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**

70. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

**Withdrawal of IPSAS 8 (2001)**

71. This Standard supersedes IPSAS 8, "Financial Reporting of Interests in Joint Ventures" issued in 2001.

**Amendments to Other IPSASs**

*The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after January 1, 2008. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.*

- A1. In International Public Sector Accounting Standards applicable at January 1, 2008, references to the current version of IPSAS 8, “Financial Reporting of Interests in Joint Ventures” are amended to IPSAS 8, “Interests in Joint Ventures.”

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the proposed International Public Sector Accounting Standards. This Basis for Conclusions only notes the IPSASB's reasons for departing from provisions of the related International Accounting Standard.*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)'s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS is not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the 'comparison with IFRS' included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 8, issued in May 2000 was based on IAS 31 (Reformatted 1994), "Financial Reporting of Interests in Joint Ventures" which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 31 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The

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<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

IASB's Bases for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)).

- BC6. IAS 31 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 7 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

### **Comparison With IAS 31**

IPSAS 8, “Interests in Joint Ventures” is drawn primarily from IAS 31, “Interests in Joint Ventures.” At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 3, “Business Combinations” and IFRS 5, “Non-current Assets Held for Sale and Discontinued Operations” to public sector entities. Therefore, IPSAS 8 does not reflect amendments made to IAS 31 consequent on the issue of IFRS 3 and IFRS 5. The main differences between IPSAS 8 and IAS 31 are as follows:

- Commentary additional to that in IAS 31 has been included in IPSAS 8 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 8 uses different terminology, in certain instances, from IAS 31. The most significant examples are the use of the terms statement of financial performance, statement of financial position and net assets/equity in IPSAS 8. The equivalent terms in IAS 31 are income statement, balance sheet and equity.
- IPSAS 8 does not use the term income, which in IAS 31 has a broader meaning than the term revenue.
- IPSAS 8 uses a different definition of joint venture from IAS 31. The term contractual arrangement has been replaced by binding arrangement.
- IPSAS 8 includes a transitional provision that permits entities which adopt proportionate consolidation treatment to not eliminate all balances and transactions between venturers, their controlled entities and entities that they jointly control for reporting periods beginning on a date within three years following the date of adopting accrual accounting for the first time in accordance with International Public Sector Accounting Standards. IAS 31 does not contain transitional provisions.

**IPSAS 9—REVENUE FROM EXCHANGE TRANSACTIONS****Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 18 (revised 1993), “Revenue” published by the International Accounting Standards Board (IASB). Extracts from IAS 18 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of International Accounting Standards Committee Foundation (IASCF).

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**IPSAS 9—REVENUE FROM EXCHANGE TRANSACTIONS****CONTENTS**


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*The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.*

## Objective

The International Accounting Standards Committee (IASC) “Framework for the Preparation and Presentation of Financial Statements” defines income as “increases in economic benefits during the accounting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.” The IASC definition of income encompasses both revenue and gains. This Standard uses the term “revenue,” which encompasses both revenues and gains, in place of the term “income.” Certain specific items to be recognized as revenues are addressed in other Standards and are excluded from the scope of this Standard. For example, gains arising on the sale of property, plant and equipment are specifically addressed in Standards on property, plant and equipment and are not covered in this Standard.

The objective of this Standard is to prescribe the accounting treatment of revenue arising from exchange transactions and events.

The primary issue in accounting for revenue is determining when to recognize revenue. Revenue is recognized when it is probable that future economic benefits or service potential will flow to the entity and these benefits can be measured reliably. This Standard identifies the circumstances in which these criteria will be met and, therefore, revenue will be recognized. It also provides practical guidance on the application of these criteria.

## Scope

1. **An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for revenue arising from the following exchange transactions and events:**
  - (a) **The rendering of services;**
  - (b) **The sale of goods; and**
  - (c) **The use by others of entity assets yielding interest, royalties and dividends.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International

Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”

4. This Standard does not deal with revenue arising from non-exchange transactions.
5. Public sector entities may derive revenues from exchange or non-exchange transactions. An exchange transaction is one in which the entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of goods, services or use of assets) to the other party in exchange. Examples of exchange transactions include:
  - (a) The purchase or sale of goods or services; or
  - (b) The lease of property, plant and equipment; at market rates.
6. In distinguishing between exchange and non-exchange revenues, substance rather than the form of the transaction should be considered. Examples of non-exchange transactions include revenue from the use of sovereign powers (for example, direct and indirect taxes, duties, and fines), grants and donations.
7. The rendering of services typically involves the performance by the entity of an agreed task over an agreed period of time. The services may be rendered within a single period or over more than one period. Examples of services rendered by public sector entities for which revenue is typically received in exchange may include the provision of housing, management of water facilities, management of toll roads, and management of transfer payments. Some agreements for the rendering of services are directly related to construction contracts, for example, those for the services of project managers and architects. Revenue arising from these agreements is not dealt with in this Standard but is dealt with in accordance with the requirements for construction contracts as specified in International Public Sector Accounting Standard (IPSAS) 11, “Construction Contracts.”
8. Goods includes goods produced by the entity for the purpose of sale, such as publications, and goods purchased for resale, such as merchandise or land and other property held for resale.
9. The use by others of entity assets gives rise to revenue in the form of:
  - (a) Interest—charges for the use of cash or cash equivalents or amounts due to the entity;
  - (b) Royalties—charges for the use of long-term assets of the entity, for example, patents, trademarks, copyrights and computer software; and

- (c) Dividends or equivalents—distributions of surpluses to holders of equity investments in proportion to their holdings of a particular class of capital.
10. This Standard does not deal with revenues:
- (a) Addressed in other International Public Sector Accounting Standards, including:
- (i) Lease agreements (see IPSAS 13, “Leases”);
- (ii) Dividends arising from investments which are accounted for under the equity method (see IPSAS 7, “Accounting for Investments in Associates”); and
- (iii) Gains from the sale of property, plant and equipment (which are dealt with in IPSAS 17, “Property, Plant and Equipment”),
- (b) Arising from insurance contracts of insurance entities;
- (c) Arising from changes in the fair value of financial assets and financial liabilities or their disposal (guidance on accounting for financial instruments can be found in international or national accounting standards addressing the recognition and measurement of financial instruments);
- (d) Arising from changes in the value of other current assets;
- (e) Arising from natural increases in herds, and agricultural and forest products; and
- (f) Arising from the extraction of mineral ores.

## Definitions

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

**Exchange transactions** are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

**Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

**Non-exchange transactions** are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

**Revenue is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.**

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

## **Revenue**

12. Revenue includes only the gross inflows of economic benefits or service potential received and receivable by the entity on its own account. Amounts collected as agent of the government or another government organization or on behalf of other third parties, for example the collection of telephone and electricity payments by the post office on behalf of entities providing such services, are not economic benefits or service potential which flow to the entity and do not result in increases in assets or decreases in liabilities. Therefore, they are excluded from revenue. Similarly, in a custodial or agency relationship, the gross inflows of economic benefits or service potential include amounts collected on behalf of the principal and which do not result in increases in net assets/equity for the entity. The amounts collected on behalf of the principal are not revenue. Instead, revenue is the amount of any commission received or receivable for the collection or handling of the gross flows.
13. Financing inflows, notably borrowings, do not meet the definition of revenue because they result in an equal change in both assets and liabilities and have no impact upon net assets/equity. Financing inflows are taken directly to the statement of financial position and added to the balances of assets and liabilities.

## **Measurement of Revenue**

14. **Revenue should be measured at the fair value of the consideration received or receivable.**
15. The amount of revenue arising on a transaction is usually determined by agreement between the entity and the purchaser or user of the asset or service. It is measured at the fair value of the consideration received or receivable taking into account the amount of any trade discounts and volume rebates allowed by the entity.
16. In most cases, the consideration is in the form of cash or cash equivalents and the amount of revenue is the amount of cash or cash equivalents received or receivable. However, when the inflow of cash or cash equivalents is deferred, the fair value of the consideration may be less than

the nominal amount of cash received or receivable. For example, an entity may provide interest free credit to the purchaser or accept a note receivable bearing a below-market interest rate from the purchaser as consideration for the sale of goods. When the arrangement effectively constitutes a financing transaction, the fair value of the consideration is determined by discounting all future receipts using an imputed rate of interest. The imputed rate of interest is the more clearly determinable of either:

- (a) The prevailing rate for a similar instrument of an issuer with a similar credit rating; or
- (b) A rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

The difference between the fair value and the nominal amount of the consideration is recognized as interest revenue in accordance with paragraphs 33 and 34.

17. When goods or services are exchanged or swapped for goods or services which are of a similar nature and value, the exchange is not regarded as a transaction which generates revenue. This is often the case with commodities like oil or milk where suppliers exchange or swap inventories in various locations to fulfill demand on a timely basis in a particular location. When goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction which generates revenue. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

### **Identification of the Transaction**

18. The recognition criteria in this Standard are usually applied separately to each transaction. However, in certain circumstances, it is necessary to apply the recognition criteria to the separately identifiable components of a single transaction in order to reflect the substance of the transaction. For example, when the price of a product includes an identifiable amount for subsequent servicing, that amount is deferred and recognized as revenue over the period during which the service is performed. Conversely, the recognition criteria are applied to two or more transactions together when they are linked in such a way that the effect cannot be understood without reference to the series of transactions as a whole. For example, an entity may sell goods and, at the same time, enter into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction; in such a case, the two transactions are dealt with together.

## Rendering of Services

19. **When the outcome of a transaction involving the rendering of services can be estimated reliably, revenue associated with the transaction should be recognized by reference to the stage of completion of the transaction at the reporting date. The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:**
- (a) **The amount of revenue can be measured reliably;**
  - (b) **It is probable that the economic benefits or service potential associated with the transaction will flow to the entity;**
  - (c) **The stage of completion of the transaction at the reporting date can be measured reliably; and**
  - (d) **The costs incurred for the transaction and the costs to complete the transaction can be measured reliably.**
20. The recognition of revenue by reference to the stage of completion of a transaction is often referred to as the percentage of completion method. Under this method, revenue is recognized in the reporting periods in which the services are rendered. For example, an entity providing property valuation services would recognize revenue as the individual valuations are completed. The recognition of revenue on this basis provides useful information on the extent of service activity and performance during a period. IPSAS 11, also requires the recognition of revenue on this basis. The requirements of that Standard are generally applicable to the recognition of revenue and the associated expenses for a transaction involving the rendering of services.
21. Revenue is recognized only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized.
22. An entity is generally able to make reliable estimates after it has agreed to the following with the other parties to the transaction:
- (a) Each party's enforceable rights regarding the service to be provided and received by the parties;
  - (b) The consideration to be exchanged; and
  - (c) The manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when

- necessary, revises the estimates of revenue as the service is performed. The need for such revisions does not necessarily indicate that the outcome of the transaction cannot be estimated reliably.
23. The stage of completion of a transaction may be determined by a variety of methods. An entity uses the method that measures reliably the services performed. Depending on the nature of the transaction, the methods may include:
- (a) Surveys of work performed;
  - (b) Services performed to date as a percentage of total services to be performed; or
  - (c) The proportion that costs incurred to date bear to the estimated total costs of the transaction. Only costs that reflect services performed to date are included in costs incurred to date. Only costs that reflect services performed or to be performed are included in the estimated total costs of the transaction.
- Progress payments and advances received from customers often do not reflect the services performed.
24. For practical purposes, when services are performed by an indeterminate number of acts over a specified time frame, revenue is recognized on a straight line basis over the specified time frame unless there is evidence that some other method better represents the stage of completion. When a specific act is much more significant than any other acts, the recognition of revenue is postponed until the significant act is executed.
25. **When the outcome of the transaction involving the rendering of services cannot be estimated reliably, revenue should be recognized only to the extent of the expenses recognized that are recoverable.**
26. During the early stages of a transaction, it is often the case that the outcome of the transaction cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the transaction costs incurred. Therefore, revenue is recognized only to the extent of costs incurred that are expected to be recoverable. As the outcome of the transaction cannot be estimated reliably, no surplus is recognized.
27. When the outcome of a transaction cannot be estimated reliably and it is not probable that the costs incurred will be recovered, revenue is not recognized and the costs incurred are recognized as an expense. When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue is recognized in accordance with paragraph 19 rather than in accordance with paragraph 25.

## Sale of Goods

28. **Revenue from the sale of goods should be recognized when all the following conditions have been satisfied:**
- (a) **The entity has transferred to the purchaser the significant risks and rewards of ownership of the goods;**
  - (b) **The entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold;**
  - (c) **The amount of revenue can be measured reliably;**
  - (d) **It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and**
  - (e) **The costs incurred or to be incurred in respect of the transaction can be measured reliably.**
29. The assessment of when an entity has transferred the significant risks and rewards of ownership to the purchaser requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the purchaser. This is the case for most sales. However, in certain other cases, the transfer of risks and rewards of ownership occurs at a different time from the transfer of legal title or the passing of possession.
30. If the entity retains significant risks of ownership, the transaction is not a sale and revenue is not recognized. An entity may retain a significant risk of ownership in a number of ways. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:
- (a) When the entity retains an obligation for unsatisfactory performance not covered by normal warranty provisions;
  - (b) When the receipt of the revenue from a particular sale is contingent on the derivation of revenue by the purchaser from its sale of the goods (for example, where a government publishing operation distributes educational material to schools on a sale or return basis);
  - (c) When the goods are shipped subject to installation and the installation is a significant part of the contract which has not yet been completed by the entity; and
  - (d) When the purchaser has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.

31. If an entity retains only an insignificant risk of ownership, the transaction is a sale and revenue is recognized. For example, a seller may retain the legal title to the goods solely to protect the collectability of the amount due. In such a case, if the entity has transferred the significant risks and rewards of ownership, the transaction is a sale and revenue is recognized. Another example of an entity retaining only an insignificant risk of ownership may be a sale when a refund is offered if the purchaser is not satisfied. Revenue in such cases is recognized at the time of sale provided the seller can reliably estimate future returns and recognizes a liability for returns based on previous experience and other relevant factors.
32. Revenue is recognized only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. In some cases, this may not be probable until the consideration is received or until an uncertainty is removed. For example, the revenue may be dependent upon the ability of another entity to supply goods as part of the contract and if there is any doubt that this will occur, recognition may be delayed until it has occurred. When the goods are supplied, the uncertainty is removed and revenue is recognized. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized.

### **Interest, Royalties and Dividends**

33. **Revenue arising from the use by others of entity assets yielding interest, royalties and dividends should be recognized using the accounting treatments set out in paragraph 34 when:**
- (a) **It is probable that the economic benefits or service potential associated with the transaction will flow to the entity; and**
  - (b) **The amount of the revenue can be measured reliably.**
34. **Revenue should be recognized using the following accounting treatments:**
- (a) **Interest should be recognized on a time proportion basis that takes into account the effective yield on the asset;**
  - (b) **Royalties should be recognized as they are earned in accordance with the substance of the relevant agreement; and**
  - (c) **Dividends or their equivalents should be recognized when the shareholder's or the entity's right to receive payment is established.**

35. The effective yield on an asset is the rate of interest required to discount the stream of future cash receipts expected over the life of the asset to equate to the initial carrying amount of the asset. Interest revenue includes the amount of amortization of any discount, premium or other difference between the initial carrying amount of a debt security and its amount at maturity.
36. When unpaid interest has accrued before the acquisition of an interest-bearing investment, the subsequent receipt of interest is allocated between pre-acquisition and post-acquisition periods; only the post-acquisition portion is recognized as revenue. When dividends on equity securities are declared from pre-acquisition net surplus, those dividends are deducted from the cost of the securities. If it is difficult to make such an allocation except on an arbitrary basis, dividends are recognized as revenue unless they clearly represent a recovery of part of the cost of the equity securities.
37. Royalties, such as petroleum royalties, accrue in accordance with the terms of the relevant agreement and are usually recognized on that basis unless, having regard to the substance of the agreement, it is more appropriate to recognize revenue on some other systematic and rational basis.
38. Revenue is recognized only when it is probable that the economic benefits or service potential associated with the transaction will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in revenue, the uncollectable amount, or the amount in respect of which recovery has ceased to be probable, is recognized as an expense, rather than as an adjustment of the amount of revenue originally recognized.

## Disclosure

39. **An entity should disclose:**
  - (a) **The accounting policies adopted for the recognition of revenue including the methods adopted to determine the stage of completion of transactions involving the rendering of services;**
  - (b) **The amount of each significant category of revenue recognized during the period including revenue arising from:**
    - (i) **The rendering of services;**
    - (ii) **The sale of goods;**
    - (iii) **Interest;**
    - (iv) **Royalties; and**
    - (v) **Dividends or their equivalents; and**

- (c) **The amount of revenue arising from exchanges of goods or services included in each significant category of revenue.**
40. Guidance on disclosure of any contingent assets and contingent liabilities can be found in IAS 37, “Provisions, Contingent Liabilities and Contingent Assets.” Contingent assets and contingent liabilities may arise from items such as warranty costs, claims, penalties or possible losses.

### **Effective Date**

41. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after July 1, 2002. Earlier application is encouraged.**
42. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity’s annual financial statements covering periods beginning on or after the date of adoption.

## Appendix

*The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning in a number of situations. The examples focus on particular aspects of a transaction and are not a comprehensive discussion of all the relevant factors which might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably, it is probable that the economic benefits or service potential will flow to the entity and the costs incurred or to be incurred can be measured reliably. The examples do not modify or override the standards.*

Public sector entities derive revenues from exchange or non-exchange transactions. This Standard deals only with revenue arising from exchange transactions. Revenue from exchange transactions is derived from:

- (a) Sale of goods or provision of services to third parties;
- (b) Sale of goods or provision of services to other government agencies; and
- (c) The use by others of entity assets yielding interest, royalties and dividends.

The application of the recognition criteria to particular transactions may be affected by:

- (a) The law in different countries, which may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples in this section of the appendix need to be read in the context of the laws in the country in which the transaction takes place; and
- (b) The nature of the relationship (contractual or otherwise) between the entity that pays and the entity that receives the revenue (that is, the entities may agree on specific points in time at which the receiving entity can recognize revenue).

### Rendering of Services

1. *Housing*  
Rental income from the provision of housing is recognized as the income is earned in accordance with the terms of the tenancy agreement.
2. *School transport*  
Revenue from fares charged to passengers for the provision of school transport is recognized as the transport is provided.
3. *Management of toll roads*  
Revenue from the management of toll roads is recognized as it is earned, based on the usage of the roads.

4. *Processing of court cases*

Revenue from the processing of court cases can be recognized either by reference to the stage of completion of the processing, or based on the periods during which the courts are in session.
5. *Management of facilities, assets or services*

Revenue from the management of facilities, assets or services is recognized over the term of the contract as the management services are provided.
6. *Science and technology research*

Revenue received from clients from contracts for undertaking science and technology research is recognized by reference to the stage of completion on individual projects.
7. *Installation fees*

Installation fees are recognized as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product in which case they are recognized when the goods are sold.
8. *Servicing fees included in the price of the product*

When the selling price of a product includes an identifiable amount for subsequent servicing (for example, after sales support and product enhancement on the sale of software), that amount is deferred and recognized as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable return on those services.
9. *Insurance agency commissions*

Insurance agency commissions received or receivable which do not require the agent to render further service are recognized as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the commission, or part thereof, is deferred and recognized as revenue over the period during which the policy is in force.
10. *Financial service fees*

The recognition of revenue for financial service fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees which are an integral part of the effective yield of a financial instrument, fees which are

earned as services are provided, and fees which are earned on the execution of a significant act.

- (a) *Fees which are an integral part of the effective yield of a financial instrument*

Such fees are generally treated as an adjustment to the effective yield. However, when the financial instrument is to be measured at fair value subsequent to its initial recognition the fees are recognized as revenue when the instrument is initially recognized.

- (b) *Fees earned as services are provided*

- (i) *Fees charged for servicing a loan*

Fees charged by an entity for servicing a loan are recognized as revenue as the services are provided. If the entity sells a loan but retains the servicing of that loan at a fee which is lower than a normal fee for such services, part of the sales price of the loan is deferred and recognized as revenue as the servicing is provided.

- (ii) *Commitment fees to originate or purchase a loan*

If it is unlikely that a specific lending arrangement will be entered into, the commitment fee is recognized as revenue on a time proportion basis over the commitment period.

- (c) *Fees earned on the execution of a significant act, which is much more significant than any other act.*

The fees are recognized as revenue when the significant act has been completed.

11. *Admission fees*

Revenue from artistic performances, banquets and other special events is recognized when the event takes place. When a subscription to a number of events is sold, the fee is allocated to each event on a basis which reflects the extent to which services are performed at each event.

12. *Tuition fees*

Revenue is recognized over the period of instruction.

13. *Initiation, entrance and membership fees*

Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognized as revenue when no significant uncertainty as to its collectability exists. If the fee entitles the member to services or publications to be provided during

the membership period, or to purchase goods or services at prices lower than those charged to non-members, it is recognized on a basis that reflects the timing, nature and value of the benefits provided.

14. *Franchise or concession fees*

Franchise or concession fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know-how. Accordingly, franchise or concession fees are recognized as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise or concession fee recognition are appropriate:

(a) *Supplies of equipment and other tangible assets*

The amount, based on the fair value of the assets sold, is recognized as revenue when the items are delivered or title passes.

(b) *Supplies of initial and subsequent services*

Fees for the provision of continuing services, whether part of the initial fee or a separate fee, are recognized as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable return, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable return on those services, is deferred and recognized as revenue as the services are rendered.

(c) *Continuing franchise or concession fees*

Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognized as revenue as the services are provided or the rights used.

(d) *Agency transactions*

Transactions may take place between the franchisor and the franchisee which, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no return. Such transactions do not give rise to revenue.

15. *Fees from the development of customized software*

Fees from the development of customized software are recognized as revenue by reference to the stage of completion of the development, including completion of services provided for post delivery service support.

**Sale of Goods**

16. “Bill and hold” sales, in which delivery is delayed at the purchaser’s request but the purchaser takes title and accepts billing

Revenue is recognized when the purchaser takes title, provided:

- (a) It is probable that delivery will be made;
- (b) The item is on hand, identified and ready for delivery to the purchaser at the time the sale is recognized;
- (c) The purchaser specifically acknowledges the deferred delivery instructions; and
- (d) The usual payment terms apply.

Revenue is not recognized when there is simply an intention to acquire or manufacture the goods in time for delivery.

17. *Goods shipped subject to conditions*

- (a) *Installation and inspection*

Revenue is normally recognized when the purchaser accepts delivery, and installation and inspection are complete. However, revenue is recognized immediately upon the purchaser's acceptance of delivery when:

- (i) The installation process is simple in nature; or
- (ii) The inspection is performed only for purposes of final determination of contract prices.

- (b) *On approval when the purchaser has negotiated a limited right of return*

If there is uncertainty about the possibility of return, revenue is recognized when the shipment has been formally accepted by the purchaser or the goods have been delivered and the time period for rejection has elapsed.

- (c) *Consignment sales under which the recipient (purchaser) undertakes to sell the goods on behalf of the shipper (seller)*

Revenue is recognized by the shipper when the goods are sold by the recipient to a third party.

- (d) *Cash on delivery sales*

Revenue is recognized when delivery is made and cash is received by the seller or its agent.

18. *Lay away sales under which the goods are delivered only when the purchaser makes the final payment in a series of installments*

Revenue from such sales is recognized when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognized when a significant deposit is received provided the goods are on hand, identified and ready for delivery to the purchaser.

19. *Orders when payment (or partial payment) is received in advance of delivery for goods not presently held in inventory, for example, the goods are still to be manufactured or will be delivered directly to the customer from a third party*

Revenue is recognized when the goods are delivered to the purchaser.

20. *Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the purchaser has a put option to require the repurchase, by the seller, of the goods*

The terms of the agreement need to be analyzed to ascertain whether, in substance, the seller has transferred the risks and rewards of ownership to the purchaser and hence revenue is recognized. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue.

21. *Sales to intermediate parties, such as distributors, dealers or others for resale*

Revenue from such sales is generally recognized when the risks and rewards of ownership have passed. However, when the purchaser is acting, in substance, as an agent, the sale is treated as a consignment sale.

22. *Subscriptions to publications and similar items*

When the items involved are of similar value in each time period, revenue is recognized on a straight line basis over the period in which the items are dispatched. When the items vary in value from period to period, revenue is recognized on the basis of the sales value of the item dispatched in relation to the total estimated sales value of all items covered by the subscription.

23. *Installment sales, under which the consideration is receivable in installments*

Revenue attributable to the sales price, exclusive of interest, is recognized at the date of sale. The sale price is the present value of the consideration, determined by discounting the installments receivable at the imputed rate of interest. The interest element is recognized as revenue as it is earned, on a time proportion basis that takes into account the imputed rate of interest.

24. *Real estate sales*

Revenue is normally recognized when legal title passes to the purchaser. However, in some jurisdictions the equitable interest in a property may vest in the purchaser before legal title passes and therefore the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognize revenue. In either case, if the seller is obliged to

perform any significant acts after the transfer of the equitable and/or legal title, revenue is recognized as the acts are performed. An example is a building or other facility on which construction has not been completed.

In some cases, real estate may be sold with a degree of continuing involvement by the seller such that the risks and rewards of ownership have not been transferred. Examples are sale and repurchase agreements which include put and call options, and agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the purchaser's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determines how the transaction is accounted for. It may be accounted for as a sale, or as a financing, leasing or some other profit sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of revenue.

A seller must also consider the means of payment and evidence of the purchaser's commitment to complete payment. For example, when the aggregate of the payments received, including the purchaser's initial down payment, or continuing payments by the purchaser, provide insufficient evidence of the purchaser's commitment to complete payment, revenue is recognized only to the extent cash is received.

### **Interest, Royalties and Dividends**

#### *25. License fees and royalties*

Fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films) are normally recognized in accordance with the substance of the agreement. As a practical matter, this may be on a straight line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time.

An assignment of rights for a fixed fee or non refundable guarantee under a non cancelable contract which permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations subsequent to delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognized at the time of sale.

In some cases, whether or not a license fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognized only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

### Comparison with IAS 18

IPSAS 9, “Revenue From Exchange Transactions” is drawn primarily from IAS 18, “Revenue.” The main differences between IPSAS 9 and IAS 18 are as follows:

- The title of IPSAS 9 differs from that of IAS 18 and this difference clarifies that IPSAS 9 does not deal with revenue from non-exchange transactions.
- The definition of revenue adopted in IPSAS 9 is similar to the definition adopted in IAS 18. The main difference is that the definition in IAS 18 refers to ordinary activities.
- At the time of issuing this Standard, the Public Sector Committee has not considered the applicability of IAS 41, “Agriculture” to public sector entities, therefore IPSAS 9 does not reflect amendments made to IAS 18 consequent upon the issuing of IAS 41.
- Commentary additional to that in IAS 18 has also been included in IPSAS 9 to clarify the applicability of the standards to accounting by public sector entities.

IPSAS 9 uses different terminology, in certain instances, from IAS 18. The most significant examples are the use of the terms entity, statement of financial position and net assets/equity in IPSAS 9. The equivalent terms in IAS 18 are enterprise, balance sheet and equity.

## **IPSAS 10—FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 29 (reformatted 1994), “Financial Reporting in Hyperinflationary Economies” published by the International Accounting Standards Board (IASB). Extracts from IAS 29 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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**IPSAS 10—FINANCIAL REPORTING IN  
HYPERINFLATIONARY ECONOMIES**

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*The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.*

## Scope

1. **An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to the primary financial statements, including the consolidated financial statements, of any entity whose functional currency is the currency of a hyperinflationary economy.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. In a hyperinflationary economy, reporting of operating results and financial position in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same reporting period, is misleading.
4. This Standard does not establish an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgment when restatement of financial statements in accordance with this Standard becomes necessary. Hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following:
  - (a) The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power.
  - (b) The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency.
  - (c) Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short.
  - (d) Interest rates, wages and prices are linked to a price index.
  - (e) The cumulative inflation rate over three years is approaching, or exceeds, 100%.
5. It is preferable that all entities that report in the currency of the same hyperinflationary economy apply this Standard from the same date. Nevertheless, this Standard applies to the financial statements of any entity

from the beginning of the reporting period in which it identifies the existence of hyperinflation in the country in whose currency it reports.

6. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”

## Definitions

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

**Carrying amount of an asset is the amount at which an asset is recognized in the statement of financial position after deducting any accumulated depreciation and accumulated impairment losses thereon.**

**Carrying amount of a liability is the amount at which a liability is recognized in the statement of financial position.**

**Cash comprises cash on hand and demand deposits.**

**Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.**

**Non-monetary items are items that are not monetary items.**

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

## The Restatement of Financial Statements

8. Prices change over time as the result of various specific or general political, economic and social forces. Specific forces such as changes in supply and demand and technological changes may cause individual prices to increase or decrease significantly and independently of each other. In addition, general forces may result in changes in the general level of prices and therefore in the general purchasing power of money.
9. In a hyperinflationary economy, financial statements are useful only if they are expressed in terms of the measuring unit current at the reporting date. As a result, this Standard applies to the primary financial statements of entities reporting in the currency of a hyperinflationary economy. Presentation of the information required by this Standard as a supplement to unrestated financial statements is not permitted. Furthermore, separate presentation of the financial statements before restatement is discouraged.

10. Many entities in the public sector include in their financial statements the related budgetary information, to facilitate comparisons with the budget. Where this occurs, the budgetary information should also be restated in accordance with this Standard.
11. **The financial statements of an entity whose functional currency is the currency of a hyperinflationary economy shall be stated in terms of the measuring unit current at the reporting date. The corresponding figures for the previous period required by International Public Sector Accounting Standard (IPSAS) 1, “Presentation of Financial Statements,” and any information in respect of earlier periods, shall also be stated in terms of the measuring unit current at the reporting date. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 47(b) and 48 of IPSAS 4, “The Effects of Changes in Foreign Exchange Rates” apply.**
12. **The surplus or deficit on the net monetary position should be separately disclosed in the statement of financial performance.**
13. The restatement of financial statements in accordance with this Standard requires the application of certain procedures as well as judgment. The consistent application of these procedures and judgments from period to period is more important than the precise accuracy of the resulting amounts included in the restated financial statements.

#### **Statement of Financial Position**

14. Statement of financial position amounts not already expressed in terms of the measuring unit current at the reporting date are restated by applying a general price index.
15. Monetary items are not restated because they are already expressed in terms of the monetary unit current at the reporting date. Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.
16. Assets and liabilities linked by agreement to changes in prices, such as index linked bonds and loans, are adjusted in accordance with the agreement in order to ascertain the amount outstanding at the reporting date. These items are carried at this adjusted amount in the restated statement of financial position.
17. All other assets and liabilities are non-monetary. Some non-monetary items are carried at amounts current at the reporting date, such as net realizable value and market value, so they are not restated. All other non-monetary assets and liabilities are restated.
18. Most non-monetary items are carried at cost or cost less depreciation; hence they are expressed at amounts current at their date of acquisition. The

restated cost, or cost less depreciation, of each item is determined by applying to its historical cost and accumulated depreciation the change in a general price index from the date of acquisition to the reporting date. Hence, property, plant and equipment, investments carried at cost, inventories of raw materials and merchandise, goodwill, patents, trademarks and similar assets are restated from the dates of their purchase. Inventories of partly-finished and finished goods are restated from the dates on which the costs of purchase and of conversion were incurred.

19. Detailed records of the acquisition dates of items of property, plant and equipment may not be available or able to be estimated. In these circumstances, it may be necessary, in the first period of application of this Standard, to use an independent professional assessment of the value of the items as the basis for their restatement.
20. A general price index may not be available for the periods for which the restatement of property, plant and equipment is required by this Standard. In these circumstances, it may be necessary to use an estimate based, for example, on the movements in the exchange rate between the functional currency and a relatively stable foreign currency.
21. Some non-monetary items are carried at amounts current at dates other than that of acquisition or that of the statement of financial position, for example, property, plant and equipment that has been revalued at some earlier date. In these cases, the carrying amounts are restated from the date of the revaluation.
22. To determine whether the restated amount of a non-monetary item has become impaired and should be reduced an entity applies relevant impairment tests in IPSAS 21, "Impairment of Non-Cash-Generating Assets," IPSAS 26, "Impairment of Cash-Generating Assets" or international and/or national accounting standards addressing impairment of goodwill. Hence, in such cases, restated amounts of property, plant and equipment, goodwill, patents and trademarks are reduced to recoverable amount or recoverable service amount, restated amounts of inventories are reduced to net realizable value or current replacement cost, and restated amounts of current investments are reduced to market value. An investee that is accounted for under the equity method may report in the currency of a hyperinflationary economy. The statement of financial position and statement of financial performance of such an investee are restated in accordance with this Standard in order to calculate the investor's share of its net assets/equity and results of operations. Where the restated financial statements of the investee are expressed in a foreign currency they are translated at closing rates.
23. The impact of inflation is usually recognized in borrowing costs. It is not appropriate both to restate the capital expenditure financed by borrowing and to capitalize that part of the borrowing costs that compensates for the

inflation during the same period. This part of the borrowing costs is recognized as an expense in the period in which the costs are incurred.

24. An entity may acquire assets under an arrangement that permits it to defer payment without incurring an explicit interest charge. Where it is impracticable to impute the amount of interest, such assets are restated from the payment date and not the date of purchase.
25. At the beginning of the first period of application of this Standard, the components of net assets/equity, except accumulated surpluses/deficits and any revaluation reserve, are restated by applying a general price index from the dates the components were contributed or otherwise arose. Any revaluation reserve that arose in previous periods is eliminated. Restated accumulated surpluses/deficits are derived from all the other amounts in the restated statement of financial position.
26. At the end of the first period and in subsequent periods, all components of net assets/equity are restated by applying a general price index from the beginning of the period or the date of contribution, if later. The movements for the period in net assets/equity are disclosed in accordance with IPSAS 1.

#### **Statement of Financial Performance**

27. This Standard requires that all items in the statement of financial performance are expressed in terms of the measuring unit current at the reporting date. Therefore all amounts need to be restated by applying the change in the general price index from the dates when the items of revenue and expenses were initially recorded.

#### **Surplus or Deficit on Net Monetary Position**

28. In a period of inflation, an entity holding an excess of monetary assets over monetary liabilities loses purchasing power and an entity with an excess of monetary liabilities over monetary assets gains purchasing power to the extent the assets and liabilities are not linked to a price level. This surplus or deficit on the net monetary position may be derived as the difference resulting from the restatement of non-monetary assets, accumulated surpluses or deficits and items in the statement of financial performance and the adjustment of index linked assets and liabilities. The surplus or deficit may be estimated by applying the change in a general price index to the weighted average for the period of the difference between monetary assets and monetary liabilities.
29. The surplus or deficit on the net monetary position is included in the statement of financial performance. The adjustment to those assets and liabilities linked by agreement to changes in prices made in accordance with paragraph 16 is offset against the surplus or deficit on net monetary position. Other items in the statement of financial performance, such as

interest revenue and expense, and foreign exchange differences related to invested or borrowed funds, are also associated with the net monetary position. Although such items are separately disclosed, it may be helpful if they are presented together with the surplus or deficit on net monetary position in the statement of financial performance.

#### **Cash Flow Statement**

30. This Standard requires that all items in the cash flow statement are expressed in terms of the measuring unit current at the reporting date.

#### **Corresponding Figures**

31. Corresponding figures for the previous reporting period, whether they were based on a historical cost approach or a current cost approach, are restated by applying a general price index so that the comparative financial statements are presented in terms of the measuring unit current at the end of the reporting period. Information that is disclosed in respect of earlier periods is also expressed in terms of the measuring unit current at the end of the reporting period. For the purpose of presenting comparative amounts in a different presentation currency, paragraphs 47(b) and 48 of IPSAS 4 apply.

#### **Consolidated Financial Statements**

32. A controlling entity that reports in the currency of a hyperinflationary economy may have controlled entities that also report in the currencies of hyperinflationary economies. The financial statements of any such controlled entity need to be restated by applying a general price index of the country in whose currency it reports before they are included in the consolidated financial statements issued by its controlling entity. Where such a controlled entity is a foreign controlled entity, its restated financial statements are translated at closing rates. The financial statements of controlled entities that do not report in the currencies of hyperinflationary economies are dealt with in accordance with IPSAS 4.
33. If financial statements with different reporting dates are consolidated, all items, whether non-monetary or monetary, need to be restated into the measuring unit current at the date of the consolidated financial statements.

#### **Selection and Use of the General Price Index**

34. The restatement of financial statements in accordance with this Standard requires the use of a general price index that reflects changes in general purchasing power. It is preferable that all entities that report in the currency of the same economy use the same index.

## **Economies Ceasing to be Hyperinflationary**

35. **When an economy ceases to be hyperinflationary and an entity discontinues the preparation and presentation of financial statements prepared in accordance with this Standard, it should treat the amounts expressed in the measuring unit current at the end of the previous reporting period as the basis for the carrying amounts in its subsequent financial statements.**

## **Disclosures**

36. **The following disclosures shall be made:**
- (a) **The fact that the financial statements and the corresponding figures for previous periods have been restated for the changes in the general purchasing power of the functional currency and, as a result, are stated in terms of the measuring unit current at the reporting date; and**
  - (b) **The identity and level of the price index at the reporting date and the movement in the index during the current and the previous reporting periods.**
37. The disclosures required by this Standard are needed to make clear the basis of dealing with the effects of hyperinflation in the financial statements. They are also intended to provide other information necessary to understand that basis and the resulting amounts.

## **Effective Date**

38. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after July 1, 2002. Earlier application is encouraged.**
39. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

## Appendix

### Restatement of Financial Statements

*This appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards and to assist in clarifying their meaning.*

The Standard sets out the requirements for the restatement of financial statements, including the consolidated financial statements, of entities reporting in the currency of a hyperinflationary economy.

The following example illustrates the process for restatement of financial statements. In preparing this illustration:

- The surplus on net monetary position for the period was indirectly derived as the difference resulting from the restatement of non-monetary assets and liabilities, accumulated surpluses/deficits and items in the statement of financial performance (see paragraph 30).
- Inventory on hand at the end of the reporting period was assumed to have been acquired later in the reporting period when the general inflation index was 170.
- The general price index was 120 at the beginning of the period, 180 at the end of the period and it averaged 150 during the period.
- Revenue and expenses, other than depreciation, are assumed to accrue evenly throughout the reporting period.
- Assets whose historical cost was 7,500 were completely depreciated and scrapped; their salvage value was zero.

## Financial Reporting Under Hyperinflation

### Example

Statement of Financial Position	1.1.X0 (Per IPSAS 12)	31.12.X0 (Unadjusted)	Indexation Factor	31.12.X0 (Per IPSAS 12)	Surplus/Deficit on Net Monetary Position
Cash and investments	5,000	10,000	–	10,000	–
Inventories	–	2,000	180/170	2,118 <i>Restated</i>	118
<i>Physical assets:</i>					
Historical cost	47,500	40,000	180/120	60,000	20,000
Accum. depreciation	<u>(22,500)</u>	<u>(20,000)</u>	180/120	<u>(30,000)</u>	<u>(10,000)</u>
Net book value	<u>25,000</u>	<u>20,000</u>	180/120	<u>30,000</u> <i>Restated</i>	10,000
<b>Total Assets</b>	<b><u>30,000</u></b>	<b><u>32,000</u></b>		<b><u>42,118</u></b>	
Borrowings	<b><u>26,000</u></b>	<b><u>26,000</u></b>	–	<b><u>26,000</u></b>	
<b>Net Assets</b>					
Brought forward	<b>4,000</b>	<b>4,000</b>	180/120	6,000 <i>Restated</i>	(2,000)
Net surplus for period (see below)		<u>2,000</u>	See below	<u>10,118</u>	<u>1,100</u>
	<b><u>4,000</u></b>	<b><u>6,000</u></b>		<b><u>16,118</u></b>	<b><u>9,218</u></b>
<b>Statement of Financial Performance</b>					
Revenues		50,000	180/150	60,000 <i>Restated</i>	10,000
Depreciation		(5,000)	180/120	(7,500) <i>Restated</i>	(2,500)
Other expenses		(43,000)	180/150	(51,600) <i>Restated</i>	(8,600)
Surplus on net monetary position				<u>9,218</u>	
Surplus for the year		<b><u>2,000</u></b>		<b><u>10,118</u></b>	<b><u>(1,100)</u></b>

NB: The Standard (paragraph 29) requires that statement of financial performance items be restated using the movement in the index from the dates that the transactions were recorded. In this example, items of revenue and expense, other than depreciation, accrue evenly over the reporting period and an average inflation rate has been applied. The surplus on net monetary position has been derived indirectly (see final column) by applying the general price index to the non-monetary items in the statement of financial position and the statement of financial performance (paragraph 30).

### **Comparison with IAS 29**

IPSAS 10, “Financial Reporting in Hyperinflationary Economies” is drawn primarily from IAS 29, “Financial Reporting in Hyperinflationary Economies.” The main differences between IPSAS 10 and IAS 29 are as follows:

- Commentary additional to that in IAS 29 has been included in IPSAS 10 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 10 uses different terminology, in certain instances, from IAS 29. The most significant examples are the use of the terms entity, revenue, statement of financial performance, statement of financial position and net assets/equity in IPSAS 10. The equivalent terms in IAS 29 are enterprise, income, income statement, balance sheet and equity.
- IAS 29 contains guidance on the restatement of current cost financial statements. IPSAS 10 does not include this guidance.

IPSAS 10 contains an appendix which illustrates the process of the restating of financial statements, using an indirect method, of an entity reporting in the currency of a hyperinflationary economy.

## IPSAS 11—CONSTRUCTION CONTRACTS

### Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 11 (revised 1993), “Construction Contracts” published by the International Accounting Standards Board (IASB). Extracts from IAS 11 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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*The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.*

## Objective

The objective of this Standard is to prescribe the accounting treatment of costs and revenue associated with construction contracts. The Standard:

- Identifies the arrangements that are to be classified as construction contracts
- Provides guidance on the types of construction contracts that can arise in the public sector; and
- Specifies the basis for recognition and disclosure of contract expenses and, if relevant, contract revenues.

Because of the nature of the activity undertaken in construction contracts, the date at which the contract activity is entered into and the date when the activity is completed usually fall into different reporting periods.

In many jurisdictions, construction contracts entered into by public sector entities will not specify an amount of contract revenue. Rather, funding to support the construction activity will be provided by an appropriation or similar allocation of general government revenue, or by aid or grant funds. In these cases, the primary issue in accounting for construction contracts is the allocation of construction costs to the reporting period in which the construction work is performed and the recognition of related expenses.

In some jurisdictions, construction contracts entered into by public sector entities may be established on a commercial basis or a non-commercial full or partial cost recovery basis. In these cases, the primary issue in accounting for construction contracts is the allocation of both contract revenue and contract costs to the reporting periods in which construction work is performed.

## Scope

1. **A contractor which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for construction contracts.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International

Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”

## Definitions

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

**Construction contract** is a contract, or a similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.

**Contractor** is an entity that performs construction work pursuant to a construction contract.

**Cost plus or cost based contract** is a construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially-based contract, an additional percentage of these costs or a fixed fee, if any.

**Fixed price contract** is a construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.

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

## Construction Contracts

5. A construction contract (the terms construction contract and contract are used interchangeably in the remainder of this Standard) may be negotiated for the construction of a single asset such as a bridge, building, dam, pipeline, road, ship or tunnel. A construction contract may also deal with the construction of a number of assets which are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use — examples of such contracts include those for the construction of reticulated water supply systems, refineries and other complex infrastructure assets.
6. For the purposes of this Standard, construction contracts include:
- (a) Contracts for the rendering of services which are directly related to the construction of the asset, for example, those for the services of project managers and architects; and
  - (b) Contracts for the destruction or restoration of assets, and the restoration of the environment following the demolition of assets.

7. For the purposes of this Standard, construction contracts also include all arrangements that are binding on the parties to the arrangement, but which may not take the form of a documented contract. For example, two government departments may enter into a formal arrangement for the construction of an asset but the arrangement may not constitute a legal contract because in that jurisdiction individual departments may not be separate legal entities with the power to contract. However, provided that the arrangement confers similar rights and obligations on the parties to it as if it were in the form of a contract, it is a construction contract for the purposes of this Standard. Such binding arrangements could include (but are not limited to) a ministerial direction, a cabinet decision, a legislative direction (such as an Act of Parliament), or a memorandum of understanding.
8. Construction contracts are formulated in a number of ways which, for the purposes of this Standard, are classified as fixed price contracts and cost plus or cost based contracts. Some commercial construction contracts may contain characteristics of both a fixed price contract and a cost plus or cost based contract, for example in the case of a cost plus or cost based contract with an agreed maximum price. In such circumstances, a contractor needs to consider all the conditions in paragraphs 31 and 32 in order to determine when to recognize contract revenue and expenses.
9. Cost plus and cost based contracts encompass both commercial and non-commercial contracts. A commercial contract will specify that revenue to cover the constructor's construction costs as agreed and generate a profit margin will be provided by the other parties to the contract. However, a public sector entity may also enter into a non-commercial contract to construct an asset for another entity in return for full or partial reimbursement of costs from that entity or other parties. In some cases, the cost recovery may encompass payments by the recipient entity and specific purpose construction grants or funding from other parties.
10. In many jurisdictions, where one public sector entity constructs assets for another public sector entity the cost of construction activity is not recovered directly from the recipient. Rather, the construction activity is funded indirectly by way of a general appropriation or other allocation of general government funds to the contractor, or from general purpose grants from third party funding agencies or other governments. These are classified as fixed price contracts for the purpose of this Standard.

**Contractor**

11. A contractor is an entity that enters into a contract to build structures, construct facilities, produce goods, or render services to the specifications of another entity. The term "contractor" includes a general or prime contractor, a subcontractor to a general contractor, or a construction manager.

## Combining and Segmenting Construction Contracts

12. The requirements of this Standard are usually applied separately to each construction contract. However, in certain circumstances, it is necessary to apply the Standard to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.
13. **When a contract covers a number of assets, the construction of each asset should be treated as a separate construction contract when:**
  - (a) **Separate proposals have been submitted for each asset;**
  - (b) **Each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and**
  - (c) **The costs and revenues of each asset can be identified.**
14. **A group of contracts, whether with a single customer or with several customers, should be treated as a single construction contract when:**
  - (a) **The group of contracts is negotiated as a single package;**
  - (b) **The contracts are so closely interrelated that they are, in effect, part of a single project with an overall margin, if any; and**
  - (c) **The contracts are performed concurrently or in a continuous sequence.**
15. **A contract may provide for the construction of an additional asset at the option of the customer or may be amended to include the construction of an additional asset. The construction of the additional asset should be treated as a separate construction contract when:**
  - (a) **The asset differs significantly in design, technology or function from the asset or assets covered by the original contract; or**
  - (b) **The price of the asset is negotiated without regard to the original contract price.**

## Contract Revenue

16. **Contract revenue should comprise:**
  - (a) **The initial amount of revenue agreed in the contract; and**
  - (b) **Variations in contract work, claims and incentive payments to the extent that:**
    - (i) **It is probable that they will result in revenue; and**
    - (ii) **They are capable of being reliably measured.**

17. Contract revenue is measured at the fair value of the consideration received or receivable. Both the initial and ongoing measurement of contract revenue are affected by a variety of uncertainties that depend on the outcome of future events. The estimates often need to be revised as events occur and uncertainties are resolved. Where a contract is a cost plus or cost based contract, the initial amount of revenue may not be stated in the contract. Instead, it may need to be estimated on a basis consistent with the terms and provisions of the contract, such as by reference to expected costs over the life of the contract.
18. In addition, the amount of contract revenue may increase or decrease from one period to the next. For example:
- (a) A contractor and a customer may agree to variations or claims that increase or decrease contract revenue in a period subsequent to that in which the contract was initially agreed;
  - (b) The amount of revenue agreed in a fixed price, cost plus or cost based contract may increase as a result of cost escalation or other clauses;
  - (c) The amount of contract revenue may decrease as a result of penalties arising from delays caused by the contractor in the completion of the contract; or
  - (d) When a fixed price contract involves a fixed price per unit of output, contract revenue increases or decreases as the number of units is increased or decreased.
19. A variation is an instruction by the customer for a change in the scope of the work to be performed under the contract. A variation may lead to an increase or a decrease in contract revenue. Examples of variations are changes in the specifications or design of the asset and changes in the duration of the contract. A variation is included in contract revenue when:
- (a) It is probable that the customer will approve the variation and the amount of revenue arising from the variation; and
  - (b) The amount of revenue can be reliably measured.
20. A claim is an amount that the contractor seeks to collect from the customer or another party as reimbursement for costs not included in the contract price. A claim may arise from, for example, customer caused delays, errors in specifications or design, and disputed variations in contract work. The measurement of the amounts of revenue arising from claims is subject to a high level of uncertainty and often depends on the outcome of negotiations. Therefore, claims are only included in contract revenue when:
- (a) Negotiations have reached an advanced stage such that it is probable that the customer will accept the claim; and

- (b) The amount that it is probable will be accepted by the customer can be measured reliably.
21. Incentive payments are additional amounts paid to the contractor if specified performance standards are met or exceeded. For example, a contract may allow for an incentive payment to the contractor for early completion of the contract. Incentive payments are included in contract revenue when:
- (a) The contract is sufficiently advanced that it is probable that the specified performance standards will be met or exceeded; and
  - (b) The amount of the incentive payment can be measured reliably.
22. Contractors should review all amounts relating to the construction contract which are paid directly to subcontractors by third party funding agencies to determine whether they meet the definition of, and recognition criteria for, revenue of the contractor under the terms of the contract. Amounts meeting the definition and recognition criteria for revenue should be accounted for by the contractor in the same way as other contract revenue. Such amounts should also be recognized as contract costs (refer to paragraph 25). Funding agencies may include national and international aid agencies and multi-lateral and bilateral development banks.

### **Contract Costs**

23. **Contract costs should comprise:**
- (a) **Costs that relate directly to the specific contract;**
  - (b) **Costs that are attributable to contract activity in general and can be allocated to the contract on a systematic and rational basis; and**
  - (c) **Such other costs as are specifically chargeable to the customer under the terms of the contract.**
24. Costs that relate directly to a specific contract include:
- (a) Site labor costs, including site supervision;
  - (b) Costs of materials used in construction;
  - (c) Depreciation of plant and equipment used on the contract;
  - (d) Costs of moving plant, equipment and materials to and from the contract site;
  - (e) Costs of hiring plant and equipment;
  - (f) Costs of design and technical assistance that are directly related to the contract;

- (g) The estimated costs of rectification and guarantee work, including expected warranty costs; and
- (h) Claims from third parties.

These costs may be reduced by any incidental revenue that is not included in contract revenue, for example revenue from the sale of surplus materials at the end of the contract.

25. Contractors should review all amounts relating to the construction contract paid directly by subcontractors and which are reimbursed by third party funding agencies, to determine whether they qualify as contract costs. Amounts meeting the definition of, and recognition criteria for, contract expenses should be accounted for by the contractor in the same way as other contract expenses. Amounts reimbursed by third party funding agencies which meet the definition of, and recognition criteria for, revenue should be accounted for by the contractor in the same way as other contract revenue (refer to paragraph 22).
26. Costs that may be attributable to contract activity in general and can be allocated to specific contracts include:
- (a) Insurance;
  - (b) Costs of design that are not directly related to a specific contract; and
  - (c) Construction overheads.

Such costs are allocated using methods that are systematic and rational and are applied consistently to all costs having similar characteristics. The allocation is based on the normal level of construction activity. Construction overheads include costs such as the preparation and processing of construction personnel payroll. Costs that may be attributable to contract activity in general and can be allocated to specific contracts also include borrowing costs when the contractor adopts the allowed alternative treatment in IPSAS 5, "Borrowing Costs."

27. Costs that are specifically chargeable to the customer under the terms of the contract may include some general administration costs and development costs for which reimbursement is specified in the terms of the contract.
28. Costs that cannot be attributed to contract activity or cannot be allocated to a contract are excluded from the costs of a construction contract. Such costs include:
- (a) General administration costs for which reimbursement is not specified in the contract;
  - (b) Selling costs;

- (c) Research and development costs for which reimbursement is not specified in the contract; and
  - (d) Depreciation of idle plant and equipment that is not used on a particular contract.
29. Contract costs include the costs attributable to a contract for the period from the date of securing the contract to the final completion of the contract. However, costs that relate directly to a contract and which are incurred in securing the contract are also included as part of the contract costs if they can be separately identified and measured reliably and it is probable that the contract will be obtained. When costs incurred in securing a contract are recognized as an expense in the period in which they are incurred, they are not included in contract costs when the contract is obtained in a subsequent period.

### **Recognition of Contract Revenue and Expenses**

30. **When the outcome of a construction contract can be estimated reliably, contract revenue and contract costs associated with the construction contract should be recognized as revenue and expenses respectively by reference to the stage of completion of the contract activity at the reporting date. An expected deficit on a construction contract to which paragraph 44 applies should be recognized as an expense immediately in accordance with paragraph 44.**
31. **In the case of a fixed price contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:**
- (a) **Total contract revenue, if any, can be measured reliably;**
  - (b) **It is probable that the economic benefits or service potential associated with the contract will flow to the entity;**
  - (c) **Both the contract costs to complete the contract and the stage of contract completion at the reporting date can be measured reliably; and**
  - (d) **The contract costs attributable to the contract can be clearly identified and measured reliably so that actual contract costs incurred can be compared with prior estimates.**
32. **In the case of a cost plus or cost based contract, the outcome of a construction contract can be estimated reliably when all the following conditions are satisfied:**
- (a) **It is probable that the economic benefits or service potential associated with the contract will flow to the entity; and**

(b) **The contract costs attributable to the contract, whether or not specifically reimbursable, can be clearly identified and measured reliably.**

33. The recognition of revenue and expenses by reference to the stage of completion of a contract is often referred to as the percentage of completion method. Under this method, contract revenue is matched with the contract costs incurred in reaching the stage of completion, resulting in the reporting of revenue, expenses and surplus/deficit which can be attributed to the proportion of work completed. This method provides useful information on the extent of contract activity and performance during a period.
34. Under the percentage of completion method, contract revenue is recognized as revenue in the statement of financial performance in the reporting periods in which the work is performed. Contract costs are usually recognized as an expense in the statement of financial performance in the reporting periods in which the work to which they relate is performed. However, where it is intended at inception of the contract that contract costs are to be fully recovered from the parties to the construction contract, any expected excess of total contract costs over total contract revenue for the contract is recognized as an expense immediately in accordance with paragraph 44.
35. A contractor may have incurred contract costs that relate to future activity on the contract. Such contract costs are recognized as an asset provided it is probable that they will be recovered. Such costs represent an amount due from the customer and are often classified as contract work in progress.
36. The outcome of a construction contract can only be estimated reliably when it is probable that the economic benefits or service potential associated with the contract will flow to the entity. However, when an uncertainty arises about the collectability of an amount already included in contract revenue, and already recognized in the statement of financial performance, the uncollectable amount or the amount in respect of which recovery has ceased to be probable is recognized as an expense rather than as an adjustment of the amount of contract revenue.
37. An entity is generally able to make reliable estimates after it has agreed to a contract which establishes:
- (a) Each party's enforceable rights regarding the asset to be constructed;
  - (b) The consideration, if any, to be exchanged; and
  - (c) The manner and terms of settlement.

It is also usually necessary for the entity to have an effective internal financial budgeting and reporting system. The entity reviews and, when necessary, revises the estimates of contract revenue and contract costs as

the contract progresses. The need for such revisions does not necessarily indicate that the outcome of the contract cannot be estimated reliably.

38. The stage of completion of a contract may be determined in a variety of ways. The entity uses the method that measures reliably the work performed. Depending on the nature of the contract, the methods may include:
- (a) The proportion that contract costs incurred for work performed to date bear to the estimated total contract costs;
  - (b) Surveys of work performed; or
  - (c) Completion of a physical proportion of the contract work.

Progress payments and advances received from customers often do not reflect the work performed.

39. When the stage of completion is determined by reference to the contract costs incurred to date, only those contract costs that reflect work performed are included in costs incurred to date. Examples of contract costs which are excluded are:
- (a) Contract costs that relate to future activity on the contract, such as costs of materials that have been delivered to a contract site or set aside for use in a contract but not yet installed, used or applied during contract performance, unless the materials have been made specially for the contract; and
  - (b) Payments made to subcontractors in advance of work to be performed under the subcontract.

40. **When the outcome of a construction contract cannot be estimated reliably:**
- (a) **Revenue should be recognized only to the extent of contract costs incurred that it is probable will be recoverable; and**
  - (b) **Contract costs should be recognized as an expense in the period in which they are incurred.**

**An expected deficit on a construction contract to which paragraph 44 applies should be recognized as an expense immediately in accordance with paragraph 44.**

41. During the early stages of a contract it is often the case that the outcome of the contract cannot be estimated reliably. Nevertheless, it may be probable that the entity will recover the contract costs incurred. Therefore, contract revenue is recognized only to the extent of costs incurred that are expected to be recoverable. As the outcome of the contract cannot be estimated reliably, no surplus or deficit is recognized. However, even though the outcome of the contract cannot be estimated reliably, it may be probable that total contract

costs will exceed total contract revenues. In such cases, any expected excess of total contract costs over total contract revenues for the contract is recognized as an expense immediately in accordance with paragraph 44.

42. Where contract costs which are to be reimbursed by parties to the contract are not probable of being recovered, they are recognized as an expense immediately. Examples of circumstances in which the recoverability of contract costs incurred may not be probable and in which contract costs may need to be recognized as an expense immediately include contracts:
- (a) Which are not fully enforceable, that is, their validity is seriously in question;
  - (b) The completion of which is subject to the outcome of pending litigation or legislation;
  - (c) Relating to properties that are likely to be condemned or expropriated;
  - (d) Where the customer is unable to meet its obligations; or
  - (e) Where the contractor is unable to complete the contract or otherwise meet its obligations under the contract.
43. **When the uncertainties that prevented the outcome of the contract being estimated reliably no longer exist, revenue and expenses associated with the construction contract should be recognized in accordance with paragraph 30 rather than in accordance with paragraph 40.**

### Recognition of Expected Deficits

44. **In respect of construction contracts in which it is intended at inception of the contract that contract costs are to be fully recovered from the parties to the construction contract, when it is probable that total contract costs will exceed total contract revenue, the expected deficit should be recognized as an expense immediately.**
45. Public sector entities may enter into construction contracts which specify that the revenue intended to cover the construction costs will be provided by the other parties to the contract. This may occur where, for example:
- (a) Government departments and agencies which are largely dependant on appropriations or similar allocations of government revenue to fund their operations are also empowered to contract with GBE's or private sector entities for the construction of assets on a commercial or full cost recovery basis; or

- (b) Government departments and agencies transact with each other on an arm's length or commercial basis as may occur under a "purchaser-provider" or similar model of government.

In these cases, an expected deficit on a construction contract is recognized immediately in accordance with paragraph 44.

- 46. As noted in paragraph 9, in some cases a public sector entity may enter into a construction contract for less than full cost recovery from the other parties to the contract. In these cases, funding in excess of that specified in the construction contract will be provided from an appropriation or other allocation of government funds to the contractor, or from general purpose grants from third party funding agencies or other governments. The requirements of paragraph 44 do not apply to these construction contracts.
- 47. In determining the amount of any deficit under paragraph 44, total contract revenue and total contract costs may include payments made directly to subcontractors by third party funding agencies in accordance with paragraphs 22 and 25.
- 48. The amount of such a deficit is determined irrespective of:
  - (a) Whether or not work has commenced on the contract;
  - (b) The stage of completion of contract activity; or
  - (c) The amount of surpluses expected to arise on other commercial construction contracts which are not treated as a single construction contract in accordance with paragraph 14.

### **Changes in Estimates**

- 49. The percentage of completion method is applied on a cumulative basis in each reporting period to the current estimates of contract revenue and contract costs. Therefore, the effect of a change in the estimate of contract revenue or contract costs, or the effect of a change in the estimate of the outcome of a contract, is accounted for as a change in accounting estimate (see IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors"). The changed estimates are used in the determination of the amount of revenue and expenses recognized in the statement of financial performance in the period in which the change is made and in subsequent periods.

### **Disclosure**

- 50. **An entity should disclose:**
  - (a) **The amount of contract revenue recognized as revenue in the period;**
  - (b) **The methods used to determine the contract revenue recognized in the period; and**

- (c) **The methods used to determine the stage of completion of contracts in progress.**
51. **An entity should disclose each of the following for contracts in progress at the reporting date:**
- (a) **The aggregate amount of costs incurred and recognized surpluses (less recognized deficits) to date;**
- (b) **The amount of advances received; and**
- (c) **The amount of retentions.**
52. Retentions are amounts of progress billings which are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified. Progress billings are amounts of contract revenue billed for work performed on a contract whether or not they have been paid by the customer. Advances are amounts of contract revenue received by the contractor before the related work is performed.
53. **An entity should present:**
- (a) **The gross amount due from customers for contract work as an asset; and**
- (b) **The gross amount due to customers for contract work as a liability.**
54. The gross amount due from customers for contract work is the net amount of:
- (a) Costs incurred plus recognized surpluses; less
- (b) The sum of recognized deficits and progress billings for all contracts in progress for which costs incurred plus recognized surpluses to be recovered by way of contract revenue (less recognized deficits) exceeds progress billings.
55. The gross amount due to customers for contract work is the net amount of:
- (a) Costs incurred plus recognized surpluses; less
- (b) The sum of recognized deficits and progress billings for all contracts in progress for which progress billings exceed costs incurred plus recognized surpluses to be recovered by way of contract revenue (less recognized deficits).
56. Guidance on the disclosure of contingent liabilities and contingent assets can be found in IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets." Contingent liabilities and contingent assets may arise from such items as warranty costs, claims, penalties or possible losses.

## **Effective Date**

57. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after July 1, 2002. Earlier application is encouraged.**
58. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

## Appendix

*The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.*

### **Disclosure of Accounting Policies**

The following are examples of accounting policy disclosures for a department which enters non-commercial construction contracts with other government agencies for full, partial or no cost recovery from the other parties to the contract. The Department is also empowered to enter into commercial construction contracts with private sector entities and Government Business Enterprises (GBEs) and to enter full cost recovery construction contracts with certain state hospitals and state universities.

#### *Non-Commercial Contracts*

Contract costs are recognized as an expense on the percentage of completion method, measured by reference to the percentage of labor hours incurred to date to estimated total labor hours for each contract. In some cases, certain construction activity and technical supervision have been subcontracted to private sector contractors for a fixed “completion of contract” fee. Where this has occurred, the subcontracted costs are recognized as an expense on the percentage of completion method for each subcontract.

Contract revenue from full cost recovery contracts and partial cost recovery contracts entered into by the Department is recognized by reference to the recoverable costs incurred during the period, measured by the proportion that recoverable costs incurred to date bear to the estimated total recoverable costs of the contract.

#### *Commercial Contracts*

Revenue from fixed price construction contracts is recognized on the percentage of completion method, measured by reference to the percentage of labor hours incurred to date to estimated total labor hours for each contract.

Revenue from cost plus or cost based contracts is recognized by reference to the recoverable costs incurred during the period plus the fee earned, measured by the proportion that costs incurred to date bear to the estimated total costs of the contract.

### **The Determination of Contract Revenue and Expenses**

The following examples deal with a non-commercial and a commercial construction contract. The examples illustrate one method of determining the stage of completion of a contract and the timing of the recognition of contract revenue and expenses (see paragraphs 30 to 43 of the Standard).

*Non-Commercial Contracts*

The Department of Works and Services (the construction contractor) has a contract to build a bridge for the Department of Roads and Highways. The Department of Works and Services is funded by appropriation. The construction contract identifies construction requirements including anticipated costs, technical specifications and timing of completion but does not provide for any recovery of construction costs directly from the Department of Roads and Highways. The construction contract is a key management planning and accountability document attesting to the design and construction qualities of the bridge. It is used as input in assessing the performance of the contracting parties in delivering services of agreed technical specification within projected cost parameters. It is also used as input to future cost projections.

The initial estimate of contract costs is 8,000. It will take three years to build the bridge. An aid agency has agreed to provide funding of 4,000 being half of the construction costs — this is specified in the construction contract.

By the end of Year 1, the estimate of contract costs has increased to 8,050. The aid agency agrees to fund half of this increase in estimated costs.

In Year 2, the Government on the advice of the Department of Roads and Highways approves a variation resulting in estimated additional contract costs of 150. The aid agency agrees to fund 50% of this variation. At the end of Year 2, costs incurred include 100 for standard materials stored at the site to be used in Year 3 to complete the project.

The Department of Works and Services determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs.

A summary of the financial data during the construction period is as follows:

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
Initial amount of revenue agreed in contract	4,000	4,000	4,000
Variation in contract revenue	–	100	100
<b>Total Contract Revenue</b>	<b>4,000</b>	<b>4,100</b>	<b>4,100</b>
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	–
<b>Total estimated contract costs</b>	<b>8,050</b>	<b>8,200</b>	<b>8,200</b>
Stage of completion	26%	74%	100%

The stage of completion for Year 2 (74%) is determined by excluding from contract costs incurred for work performed to date the 100 for standard materials stored at the site for use in Year 3.

The amounts of contract revenue and expenses recognized in the statement of financial performance in the three years are as follows:

	<b>To Date</b>	<b>Recognized in prior years</b>	<b>Recognized in current year</b>
<b>Year 1</b>			
Revenue (4,000 × .26)	1,040		1,040
Expenses (8,050 × .26)	<u>2,093</u>		<u>2,093</u>
<b>Year 2</b>			
Revenue (4,100 × .74)	3,034	1,040	1,994
Expenses (8,200 × .74)	<u>6,068</u>	2,093	<u>3,975</u>
<b>Year 3</b>			
Revenue (4,100 × 1.00)	4,100	3,034	1,066
Expenses (8,200 × 1.00)	<u>8,200</u>	6,068	<u>2,132</u>

*Commercial Contracts*

The Department of Works and Services (the contractor) while predominantly funded by appropriation is empowered to undertake limited construction work on a commercial basis for private sector entities. With the authority of the Minister, the Department has entered a fixed price commercial contract for 9,000 to build a bridge.

The initial amount of revenue agreed in the contract is 9,000. The contractor's initial estimate of contract costs is 8,000. It will take three years to build the bridge.

By the end of Year 1, the Department's estimate of contract costs has increased to 8,050.

In Year 2, the customer approves a variation resulting in an increase in contract revenue of 200 and estimated additional contract costs of 150. At the end of Year 2, costs incurred include 100 for standard materials stored at the site to be used in Year 3 to complete the project.

The Department determines the stage of completion of the contract by calculating the proportion that contract costs incurred for work performed to date bear to the latest estimated total contract costs. A summary of the financial data during the construction period is as follows:

	<b>Year 1</b>	<b>Year 2</b>	<b>Year 3</b>
Initial amount of revenue agreed in contract	9,000	9,000	9,000
Variation	–	200	200
<b>Total Contract Revenue</b>	<b>9,000</b>	<b>9,200</b>	<b>9,200</b>
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	–
<b>Total estimated contract costs</b>	<b>8,050</b>	<b>8,200</b>	<b>8,200</b>
Estimated surplus	950	1,000	1,000
Stage of completion	26%	74%	100%

The stage of completion for Year 2 (74%) is determined by excluding from contract costs incurred for work performed to date the 100 for standard materials stored at the site for use in Year 3.

The amounts of revenue, expenses and surplus recognized in the statement of financial performance in the three years are as follows:

	To Date	Recognized in prior years	Recognized in current year
<b>Year 1</b>			
Revenue (9,000 × .26)	2,340		2,340
Expenses (8,050 × .26)	<u>2,093</u>		<u>2,093</u>
Surplus	<u>247</u>		<u>247</u>
<b>Year 2</b>			
Revenue (9,200 × .74)	6,808	2,340	4,468
Expenses (8,200 × .74)	<u>6,068</u>	<u>2,093</u>	<u>3,975</u>
Surplus	<u>740</u>	<u>247</u>	<u>493</u>
<b>Year 3</b>			
Revenue (9,200 × 1.00)	9,200	6,808	2,392
Expenses (8,200 × 1.00)	8,200	<u>6,068</u>	2,132
Surplus	<u>1,000</u>	<u>740</u>	<u>260</u>

**Contract Disclosures***Appropriation/Aid Funded Contracts and Full Cost Recovery Contracts*

The Department of Works and Services was recently created as the entity to manage the construction of major buildings and roadworks for other government entities. It is funded predominantly by appropriation but with the approval of the Minister is empowered to undertake construction projects financed by national or international aid agencies. It has its own construction capabilities and can also subcontract. With the approval of the Minister, the Department may also undertake construction work on a commercial basis for private sector entities and Government Business Enterprises (GBEs) and on a full cost recovery basis for state hospitals and state run universities.

The Department of Works and Services has reached the end of its first year of operations. All its contract costs incurred have been paid for in cash and all its progress billings (to aid agencies that have commissioned construction work) have been received in cash. No advances to the Department for construction work were made during the period. Contract costs incurred for contracts B and C include the cost of materials that have been purchased for the contract but which have not been used in contract performance to date. No commercial contracts have been undertaken this year. (See below for examples of commercial contracts.)

- Contract A is funded out of general appropriation revenue. (The contract includes no “contract revenue” as defined.)

CONSTRUCTION CONTRACTS

- Contract B is with the Department of Education and the XX Aid Agency which is funding 50% of the construction costs. (50% of the contract cost is to be reimbursed by parties to the contract and therefore is “contract revenue” as defined.)
- Contract C is totally funded by the National University. (The terms of the arrangement specify that all of the contract costs are to be reimbursed by the National University from the University’s major construction fund. Therefore, “contract revenue” as defined equals contract costs.)

The status of the three contracts in progress at the end of Year 1 is as follows:

	<b>Contract</b>			<b>Total</b>
	<b>A</b>	<b>B</b>	<b>C</b>	
Contract Revenue recognized in accordance with paragraph 30	–	225	350	575
Contract Expenses recognized in accordance with paragraph 30	110	450	350	910
Contract Costs funded by Appropriation	110	225	–	335
Contract Costs incurred in the period	110	510	450	1,070
– recognized as expenses (para 30)	110	450	350	910
– recognized as an asset (para 35)	–	60	100	160
Contract Revenue (see above)	–	225	350	575
Progress Billings (para 52)	–	225	330	555
Unbilled Contract Revenue	–	–	20	20
Advances (para 52)	–	–	–	–

The amounts to be disclosed in accordance with the standard are as follows:

Contract revenue recognized as revenue in the period (para 50(a))	575
Contract costs incurred to date (para 51(a)) (there are no recognized surpluses/less recognized deficits)	1,070

Gross amount due from contract customers for contract work (determined in accordance with paragraph 54 and presented as an asset in accordance with paragraph 53(a))	150
The amounts to be disclosed in accordance with the standard are as follows:	
Contract revenue recognized as revenue in the period (para 50(a))	575
Contract costs incurred to date (para 51(a)) (there are no recognized surpluses/less recognized deficits)	1,070
Gross amount due from contract customers for contract work (determined in accordance with paragraph 54 and presented as an asset in accordance with paragraph 53(a))	150

Amounts to be disclosed in accordance with paragraphs 51(a) and 53(a) are as follows (*Note: contract revenue for B is 50% of contract costs*):

	A	B	C	Total
Contract costs incurred	110	510	450	1,070
Progress billings	0	225	330	555
Due from aid agencies and customers	–	30	120	150

The amount disclosed in accordance with paragraph 51(a) is the same as the amount for the current period because the disclosures relate to the first year of operation.

#### *Commercial Contracts*

The Division of National Construction Works has been established within the Department of Works and Services to undertake construction work on a commercial basis for GBEs and private sector entities at the direction, and with the approval, of the Minister. The Division has reached the end of its first year of operations. All its contract costs incurred have been paid for in cash and all its progress billings and advances have been received in cash. Contract costs incurred for contracts B, C and E include the cost of materials that have been purchased for the contract but which have not been used in contract performance to date. For contracts B, C and E, the customers have made advances to the contractor for work not yet performed.

CONSTRUCTION CONTRACTS

The status of its five contracts in progress at the end of Year 1 is as follows:

	Contract					Total
	A	B	C	D	E	
Contract revenue recognized in accordance with paragraph 30	145	520	380	200	55	1,300
Contract expenses recognized in accordance with paragraph 30	110	450	350	250	55	1,215
Expected deficits recognized in accordance with paragraph 44	–	–	–	40	30	70
Recognized surpluses less recognized deficits	35	70	30	(90)	(30)	15
Contract costs incurred in the period	110	510	450	250	100	1,420
Contract costs incurred recognized as contract expenses in the period in accordance with paragraph 30	110	450	350	250	55	1,215
Contract costs that relate to future activity recognized as an asset in accordance with paragraph 35	–	60	100	–	45	205
Contract revenue (see above)	145	520	380	200	55	1,300
Progress billings (para 52)	100	520	380	180	55	1,235
Unbilled contract Revenue	45	–	–	20	–	65
Advances (para 52)	–	80	20	–	25	125

The amounts to be disclosed in accordance with the Standard are as follows:

Contract revenue recognized as revenue in the period (para 50(a))	1,300
Contract costs incurred and recognized surpluses (less recognized deficits) to date (para 51(a))	1,435
Advances received (para 51(b))	125
Gross amount due from customers for contract work — presented as an asset in accordance with paragraph 53(a)	220
Gross amount due to customers for contract work — presented as an asset in accordance with paragraph 53(b)	(20)

CONSTRUCTION CONTRACTS

The amounts to be disclosed in accordance with paragraphs 51(a), 53(a) and 53(b) are calculated as follows:

	<b>A</b>	<b>B</b>	<b>C</b>	<b>D</b>	<b>E</b>	<b>Total</b>
Contract costs incurred	110	510	450	250	100	1,420
Recognized surpluses less recognized deficits	35	70	30	(90)	(30)	15
	145	580	480	160	70	1,435
Progress billings	100	520	380	180	55	1,235
Due from customers	45	60	100	–	15	220
Due to customers	–	–	–	(20)	–	(20)

The amount disclosed in accordance with paragraph 51(a) is the same as the amount for the current period because the disclosures relate to the first year of operation.

### **Comparison with IAS 11**

IPSAS 11, “Construction Contracts” is drawn primarily from IAS 11, “Construction Contracts.” The main differences between IPSAS 11 and IAS 11 are as follows:

- Commentary additional to that in IAS 11 has been included in IPSAS 11 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 11 uses different terminology, in certain instances, from IAS 11. The most significant examples are the use of the terms entity, revenue and statement of financial performance in IPSAS 11. The equivalent terms in IAS 11 are enterprise, income and income statement.
- IPSAS 11 includes binding arrangements that do not take the form of a legal contract within the scope of the Standard.
- IPSAS 11 includes cost based and non-commercial contracts within the scope of the Standard.
- IPSAS 11 makes it clear that the requirement to recognize an expected deficit on a contract immediately it becomes probable that contract costs will exceed total contract revenues applies only to contracts in which it is intended at inception of the contract that contract costs are to be fully recovered from the parties to that contract.

IPSAS 11 includes additional examples to illustrate the application of the Standard to non-commercial construction contracts.

## IPSAS 12—INVENTORIES

### Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 2 (revised 2003), “Inventories” published by the International Accounting Standards Board (IASB). Extracts from IAS 2 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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International Public Sector Accounting Standard (IPSAS) 12, “Inventories” is set out in paragraphs 1-53. All the paragraphs have equal authority. IPSAS 12 should be read in the context of the Basis for Conclusion, and the “Preface to International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## **Introduction**

IN1. International Public Sector Accounting Standard (IPSAS) 12, “Inventories,” replaces IPSAS 12, “Inventories” (issued July 2001), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## **Reasons for Revising IPSAS 12**

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 12 as a response to the International Accounting Standards Board’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 12, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 2, “Inventories” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 2 for a public sector specific reason; such variances are retained in this IPSAS 12 and are noted in the Comparison with IAS 2. Any changes to IAS 2 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 12.

## **Changes from Previous Requirements**

IN4. The main changes from the previous version of IPSAS 12 are described below.

## **Objective and Scope**

IN5. The Standard clarifies in paragraphs 1 and 2 that the Standard applies to all inventories that are not specifically excluded from its scope. Previously, IPSAS12 applied to “accounting for inventories under the historical cost system.”

IN6. The Standard establishes a clear distinction between those inventories (a) that are entirely outside the scope of the Standard; and (b) that are outside the scope of measurement requirements but within the scope of the other requirements in the Standard (see paragraphs 2 and 3).

IN7. Inventories that are outside the measurement requirements of the Standard are those held by: (a) producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realizable value in accordance with well-established practices in those industries, and (b) commodity broker-traders measured at fair value less costs to sell.

- IN8. To qualify for this exemption, changes in recognized amounts of these inventories are to be included in surplus or deficit in the period of the changes.
- IN9. Previously, IPSAS 12 did not make this distinction with respect to scope exemptions.

### **Cost of Inventories**

- IN10. The Standard prohibits exchange differences arising directly on the recent acquisitions of inventories invoiced in a foreign currency from being included in the cost of purchase of inventories (see previous paragraph 15).
- IN11. Previously, this was allowed under the allowed alternative treatment contained in the superseded version of IPSAS 4, “The Effects of Changes in Foreign Exchanges Rates.” This alternative treatment has also been eliminated in IPSAS 4.
- IN12. The Standard requires in paragraph 26 that when inventories are purchased with deferred settlement terms, the difference between the purchase price for normal credit terms and the amount paid is recognized as interest expense over the period of financing. Previously, IPSAS 12 did not contain this requirement.

### **Disclosures**

- IN13. The Standard requires the following additional disclosure items (see paragraph 45):
- The carrying amount of inventories carried at fair value less costs to sell.
  - The amount of any write-down of inventories recognized as an expense in the period.
- IN14. Previously, IPSAS 12 did not contain these disclosure requirements

**IPSAS 12—INVENTORIES****Objective**

1. The objective of this Standard is to prescribe the accounting treatment for inventories. A primary issue in accounting for inventories is the amount of cost to be recognized as an asset and carried forward until the related revenues are recognized. This Standard provides guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realizable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

**Scope**

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for all inventories except:**
  - (a) **Work in progress arising under construction contracts, including directly related service contracts (see International Public Sector Accounting Standard (IPSAS) 11, “Construction Contracts”);**
  - (b) **Financial instruments;**
  - (c) **Biological assets related to agricultural activity and agricultural produce at the point of harvest (see the relevant international or national accounting standard dealing with agriculture); and**
  - (d) **Work in progress of services to be provided for no or nominal consideration directly in return from the recipients.**
3. **This Standard does not apply to the measurement of inventories held by:**
  - (a) **Producers of agricultural and forest products, agricultural produce after harvest, and minerals and mineral products, to the extent that they are measured at net realizable value in accordance with well-established practices in those industries. When such inventories are measured at net realizable value, changes in that value are recognized in surplus or deficit in the period of the change.**
  - (b) **Commodity broker-traders who measure their inventories at fair value less costs to sell. When such inventories are measured at fair value less costs to sell, changes in fair value less costs to sell are recognized in surplus or deficit in the period of the change.**
4. **This Standard applies to all public sector entities other than Government Business Enterprises.**

5. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”
6. The inventories referred to in paragraph 2(d) are not encompassed by International Accounting Standard (IAS) 2, “Inventories” and are excluded from the scope of this Standard because they involve specific public sector issues that require further consideration.
7. The inventories referred to in paragraph 3(a) are measured at net realizable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or minerals have been extracted and sale is assured under a forward contract or a government guarantee, or when an active market exists and there is a negligible risk of failure to sell. These inventories are excluded from only the measurement requirements of this Standard.
8. Broker-traders are those who buy or sell commodities for others or on their own account. The inventories referred to in paragraph 3(b) are principally acquired with the purpose of selling in the near future and generating a surplus from fluctuations in price or broker-traders’ margin. When these inventories are measured at fair value less costs to sell, they are excluded from only the measurement requirements of this Standard.

## Definitions

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

**Current replacement cost** is the cost the entity would incur to acquire the asset on the reporting date.

**Exchange transactions** are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

**Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

**Inventories** are assets:

- (a) **In the form of materials or supplies to be consumed in the production process;**

- (b) **In the form of materials or supplies to be consumed or distributed in the rendering of services;**
- (c) **Held for sale or distribution in the ordinary course of operations; or**
- (d) **In the process of production for sale or distribution.**

**Net realizable value is the estimated selling price in the ordinary course of operations less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.**

**Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.**

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

### **Net Realizable Value**

10. Net realizable value refers to the net amount that an entity expects to realize from the sale of inventory in the ordinary course of operations. Fair value reflects the amount for which the same inventory could be exchanged between knowledgeable and willing buyers and sellers in the marketplace. The former is an entity-specific value; the latter is not. Net realizable value for inventories may not equal fair value less costs to sell.

### **Inventories**

11. Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by an entity and held for resale, or land and other property held for sale. Inventories also encompass finished goods produced, or work in progress being produced, by the entity. Inventories also include materials and supplies awaiting use in the production process and goods purchased or produced by an entity, which are for distribution to other parties for no charge or for a nominal charge; for example, educational books produced by a health authority for donation to schools. In many public sector entities inventories will relate to the provision of services rather than goods purchased and held for resale or goods manufactured for sale. In the case of a service provider, inventories include the costs of the service, as described in paragraph 28, for which the entity has not yet recognized the related revenue (guidance on recognition of revenue can be found in IPSAS 9, “Revenue from Exchange Transactions”).

12. Inventories in the public sector may include:
- (a) Ammunition;
  - (b) Consumable stores;
  - (c) Maintenance materials;
  - (d) Spare parts for plant and equipment other than those dealt with in Standards on Property, Plant And Equipment;
  - (e) Strategic stockpiles (for example, energy reserves);
  - (f) Stocks of unissued currency;
  - (g) Postal service supplies held for sale (for example, stamps);
  - (h) Work in progress, including:
    - (i) Educational/training course materials; and
    - (ii) Client services (for example, auditing services) where those services are sold at arm's length prices; and
  - (i) Land/property held for sale.
13. Where the government controls the rights to create and issue various assets, including postal stamps and currency, these items of inventory are recognized as inventories for the purposes of this Standard. They are not reported at face value, but measured in accordance with paragraph 15, that is at their printing or minting cost.
14. When a government maintains strategic stockpiles of various reserves, such as energy reserves (for example, oil), for use in emergency or other situations (for example, natural disasters or other civil defense emergencies), these stockpiles are recognized as inventories for the purposes of this Standard and treated accordingly.

### Measurement of Inventories

15. **Inventories shall be measured at the lower of cost and net realizable value, except where paragraph 16 applies.**
16. **Where inventories are acquired through a non-exchange transaction, their cost shall be measured at their fair value as at the date of acquisition.**
17. **Inventories shall be measured at the lower of cost and current replacement cost where they are held for:**
- (a) **Distribution at no charge or for a nominal charge; or**
  - (b) **Consumption in the production process of goods to be distributed at no charge or for a nominal charge.**

**Cost of Inventories**

18. **The cost of inventories shall comprise all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.**

**Costs of Purchase**

19. The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and supplies. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

**Costs of Conversion**

20. The costs of converting work-in-progress inventories into finished goods inventories are incurred primarily in a manufacturing environment. The costs of conversion of inventories include costs directly related to the units of production, such as direct labor. They also include a systematic allocation of fixed and variable production overheads that are incurred in converting materials into finished goods. Fixed production overheads are those indirect costs of production that remain relatively constant regardless of the volume of production, such as depreciation and maintenance of factory buildings and equipment, and the cost of factory management and administration. Variable production overheads are those indirect costs of production that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labor.
21. The allocation of fixed production overheads to the costs of conversion is based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognized as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.
22. For example, the allocation of costs, both fixed and variable, incurred in the development of undeveloped land held for sale into residential or commercial landholdings, could include costs relating to landscaping, drainage, pipe laying for utility connection, etc.

23. A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, they are allocated between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, they are often measured at net realizable value and this value is deducted from the cost of the main product. As a result, the carrying amount of the main product is not materially different from its cost.

#### **Other Costs**

24. Other costs are included in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include non-production overheads or the costs of designing products for specific customers in the cost of inventories.
25. Examples of costs excluded from the cost of inventories and recognized as expenses in the period in which they are incurred are:
- (a) Abnormal amounts of wasted materials, labor, or other production costs;
  - (b) Storage costs, unless those costs are necessary in the production process before a further production stage;
  - (c) Administrative overheads that do not contribute to bringing inventories to their present location and condition; and
  - (d) Selling costs.
26. IPSAS 5, “Borrowing Costs” identifies limited circumstances where borrowing costs are included in the cost of inventories.
27. An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognized as interest expense over the period of the financing.

#### **Cost of Inventories of a Service Provider**

28. To the extent that service providers have inventories except those referred to in paragraph 2(d), they measure them at the costs of their production. These costs consist primarily of the labor and other costs of personnel

directly engaged in providing the service, including supervisory personnel, and attributable overheads. The costs of labor not engaged in providing the service are not included. Labor and other costs relating to sales and general administrative personnel are not included but are recognized as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include surplus margins or non-attributable overheads that are often factored into prices charged by service providers.

#### **Cost of Agricultural Produce Harvested from Biological assets**

29. In accordance with the relevant international or national accounting standard dealing with agriculture, inventories comprising agricultural produce that an entity has harvested from its biological assets may be measured on initial recognition at their fair value less estimated point-of-sale costs at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

#### **Techniques for the Measurement of Cost**

30. Techniques for the measurement of the cost of inventories, such as the standard cost method or the retail method, may be used for convenience if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labor, efficiency and capacity utilization. They are regularly reviewed and, if necessary, revised in the light of current conditions.
31. Inventories may be transferred to the entity by means of a non-exchange transaction. For example, an international aid agency may donate medical supplies to a public hospital in the aftermath of a natural disaster. Under such circumstances, the cost of inventory is its fair value as at the date it is acquired.

#### **Cost Formulas**

32. **The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall be assigned by using specific identification of their individual costs.**
33. Specific identification of costs means that specific costs are attributed to identified items of inventory. This is an appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced. However, specific identification of costs is inappropriate when there are large numbers of items of inventory which are ordinarily interchangeable. In such circumstances, the method of selecting those items that remain in inventories could be used to obtain predetermined effects on the net surplus or deficit for the period.

34. **When applying paragraph 33 an entity shall use the same cost formula for all inventories having similar nature and use to the entity. For inventories with different nature or use (for example, certain commodities used in one segment and the same type of commodities used in another segment), different cost formulas may be justified. A difference in geographical location of inventories (and in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.**
35. **The cost of inventories, other than those dealt with in paragraph 32, shall be assigned by using the first-in, first-out (FIFO) or weighted average cost formulas. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified.**
36. For example, inventories used in one segment may have a use to the entity different from the same type of inventories used in another segment. However, a difference in geographical location of inventories, by itself, is not sufficient to justify the use of different cost formulas.
37. The FIFO formula assumes that the items of inventory that were purchased first are sold first, and consequently the items remaining in inventory at the end of the period are those most recently purchased or produced. Under the weighted average cost formula, the cost of each item is determined from the weighted average of the cost of similar items at the beginning of a period and the cost of similar items purchased or produced during the period. The average may be calculated on a periodic basis, or as each additional shipment is received, depending upon the circumstances of the entity.

### **Net Realizable Value**

38. The cost of inventories may not be recoverable if those inventories are damaged, if they have become wholly or partially obsolete, or if their selling prices have declined. The cost of inventories may also not be recoverable if the estimated costs of completion or the estimated costs to be incurred to make the sale, exchange or distribution have increased. The practice of writing inventories down below cost to net realizable value is consistent with the view that assets are not to be carried in excess of the future economic benefits or service potential expected to be realized from their sale, exchange, distribution or use.
39. Inventories are usually written down to net realizable value on an item by item basis. In some circumstances, however, it may be appropriate to group similar or related items. This may be the case with items of inventory that have similar purposes or end uses and cannot practicably be evaluated separately from other items in that product line. It is not appropriate to write-down inventories based on a classification of inventory, for example,

finished goods, or all the inventories in a particular operation or geographical segment. Service providers generally accumulate costs in respect of each service for which a separate selling price is charged. Therefore, each such service is treated as a separate item.

40. Estimates of net realizable value also take into consideration the purpose for which the inventory is held. For example, the net realizable value of the quantity of inventory held to satisfy firm sales or service contracts is based on the contract price. If the sales contracts are for less than the inventory quantities held, the net realizable value of the excess is based on general selling prices. Guidance on the treatment of provisions or contingent liabilities, such as those arising from firm sales contracts in excess of inventory quantities held, and on firm purchase contracts can be found in IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets."
41. Materials and other supplies held for use in the production of inventories are not written down below cost if the finished products in which they will be incorporated are expected to be sold, exchanged or distributed at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products exceeds net realizable value, the materials are written down to net realizable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realizable value.
42. A new assessment is made of net realizable value in each subsequent period. When the circumstances that previously caused inventories to be written down below cost no longer exist or when there is clear evidence of an increase in net realizable value because of changed economic circumstances, the amount of the write-down is reversed (i.e., the reversal is limited to the amount of the original write-down) so that the new carrying amount is the lower of the cost and the revised net realizable value. This occurs, for example, when an item of inventory, that is carried at net realizable value, because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

### **Distributing Goods at No Charge or for a Nominal Charge**

43. A public sector entity may hold inventories whose future economic benefits or service potential are not directly related to their ability to generate net cash inflows. These types of inventories may arise when a government has determined to distribute certain goods at no charge or for a nominal amount. In these cases, the future economic benefits or service potential of the inventory for financial reporting purposes is reflected by the amount the entity would need to pay to acquire the economic benefits or service potential if this was necessary to achieve the objectives of the entity. Where the economic benefits or service potential cannot be acquired in the market, an estimate of replacement cost will need to be made. If the purpose for

which the inventory is held changes, then the inventory is valued using the provisions of paragraph 15.

### **Recognition as an Expense**

44. **When inventories are sold, exchanged or distributed the carrying amount of those inventories shall be recognized as an expense in the period in which the related revenue is recognized. If there is no related revenue, the expense is recognized when the goods are distributed or related service is rendered. The amount of any write-down of inventories and all losses of inventories shall be recognized as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories shall be recognized as a reduction in the amount of inventories recognized as an expense in the period in which the reversal occurs.**
45. For a service provider, the point when inventories are recognized as expenses normally occurs when services are rendered, or upon billing for chargeable services.
46. Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognized as an expense during the useful life of that asset.

### **Disclosure**

47. **The financial statements shall disclose:**
  - (a) **The accounting policies adopted in measuring inventories, including the cost formula used;**
  - (b) **The total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;**
  - (c) **The carrying amount of inventories carried at fair value less costs to sell;**
  - (d) **The amount of inventories recognized as an expense during the period;**
  - (e) **The amount of any write-down of inventories recognized as an expense in the period in accordance with paragraph 42;**
  - (f) **The amount of any reversal of any write-down that is recognized in the statement of financial performance in the period in accordance with paragraph 42;**
  - (g) **The circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 42; and**

(h) **The carrying amount of inventories pledged as security for liabilities.**

48. Information about the carrying amounts held in different classifications of inventories and the extent of the changes in these assets is useful to financial statement users. Common classifications of inventories are merchandise, production supplies, materials, work in progress and finished goods. The inventories of a service provider may be described as work in progress.
49. The amount of inventories recognized as an expense during the period consists of those costs previously included in the measurement of inventory that has now been sold, exchanged or distributed, and unallocated production overheads and abnormal amounts of production costs of inventories. The circumstances of the entity may also warrant the inclusion of other costs, such as distribution costs.
50. Some entities adopt a format for surplus or deficit that results in amounts being disclosed other than the cost of inventories recognized as an expense during the period. Under this format, an entity presents an analysis of expenses using a classification based on the nature of expenses. In this case, the entity discloses the costs recognized as an expense for raw materials and consumables, labor costs and other costs together with the amount of the net change in inventories for the period.

### **Effective Date**

51. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
52. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

### **Withdrawal of IPSAS 12 (2001)**

53. This Standard supersedes IPSAS 12, "Inventories" issued in 2001.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the proposed International Public Sector Accounting Standards. This Basis for Conclusions only notes the IPSASB's reasons for departing from the provisions of the related International Accounting Standard.*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)'s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the 'comparison with IFRS' included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 12, issued in July 2001 was based on IAS 2 (Revised 1993), "Inventories" which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 2 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The

<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

IASB's Bases for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)).

- BC6. IAS 2 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 12 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

### Comparison with IAS 2

IPSAS 12, “Inventories” is drawn primarily from IAS 2 (revised 2003), “Inventories.” The main differences between IPSAS 12 and IAS 2 are as follows:

- At the time of issuing this Standard, the Public Sector Committee has not considered the applicability of IAS 41, “Agriculture,” to public sector entities, therefore IPSAS 12 does not reflect amendments made to IAS 2 consequent upon the issuing of IAS 41.
- IPSAS 12 uses a different definition from IAS 2, the difference recognizes that in the public sector some inventories are distributed at no charge or for a nominal charge.
- IPSAS 12 clarifies that work-in-progress of services which are to be distributed for no or nominal consideration directly in return from the recipients are excluded from the scope of the Standard.
- A definition of current replacement cost, which is additional to the definitions in IAS 2, has been included in IPSAS 12.
- IPSAS 12 requires that where inventories are acquired through a non-exchange transaction their cost is their fair value as at the date of acquisition.
- IPSAS 12 requires that where inventories are provided at no charge or for a nominal charge, they are to be valued at the lower of cost and current replacement cost.
- Commentary additional to that in IAS 2 has been included in IPSAS 12 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 12 uses different terminology, in certain instances, from IAS 2. The most significant example is the use of the terms statement of financial performance in IPSAS 12. The equivalent term in IAS 2 is income statement.
- IPSAS 12 does not use the term income, which in IAS 2 has a broader meaning than the term revenue.

## **IPSAS 13—LEASES**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 17 (revised 2003), “Leases” published by the International Accounting Standards Board (IASB). Extracts from IAS 17 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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Basis for Conclusions

Comparison with IAS 17

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in paragraphs 1–87. All the paragraphs have equal authority. IPSAS 13 should be read in the context of the Basis for Conclusion, and the “Preface to International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

IN1. International Public Sector Accounting Standard (IPSAS) 13, “Leases,” replaces IPSAS 13, “Leases” (issued December 2001), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## Reasons for Revising IPSAS 13

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 13 as a response to the International Accounting Standards Board’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 13, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 17, “Leases” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 17 for a public sector specific reason; such variances are retained in this IPSAS 13 and are noted in the Comparison with IAS 17. Any changes to IAS 17 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 13.

## Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 13 are described below.

## Definitions

IN5. The Standard defines “initial direct costs” in paragraph 8 as “incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or trader lessors.” Previously, IPSAS 13 did not contain this definition.

IN6. The Standard defines “commencement of the lease term” in paragraph 8 as “the date from which the lessee is entitled to exercise its right to use the leased asset.” It is distinguished from the inception of the lease, which is defined as “the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease.” The Standard clarifies that recognition takes place at the commencement of the lease term based on values measured at the inception of the lease. If the lease is adjusted for changes in the lessor’s costs between the inception of the lease and the commencement of the lease term, the effect of any such changes is deemed to have taken place at the inception (see paragraph 9).

IN7. Previously, IPSAS 13 did not define “commencement of the lease” and implicitly assumed that commencement and inception were simultaneous.

## Classification of Leases of Land and Building

- IN8. The Standard requires in paragraph 20 that an entity consider the land and buildings elements separately when classifying a lease of land and buildings. Normally, the land element is classified as an operating lease unless the title passes to the lessee at the end of the lease term. The buildings element is classified as an operating or finance lease by applying the classification criteria in the Standard. The minimum lease payments are allocated between the land and buildings elements in proportion to the relative fair values of the leasehold interests in the land and buildings elements of the lease.
- IN9. Previously, IPSAS 13 was not explicit about how to classify a lease of land and buildings and how to allocate the lease payment between them.

## Initial Direct Costs incurred by Lessors

- IN10. The Standard requires lessors to include the initial direct costs incurred in negotiating a finance lease in the initial measurement of finance lease receivables. For operating leases, such initial direct costs are added to the carrying amount of the leased asset and recognized over the lease term on the same basis as the lease revenue. This treatment does not apply to manufacturer or trader lessors. Manufacturer or trader lessors recognize this type of costs as an expense when the gain or loss is recognized. (see paragraphs 50, 55 and 65)
- IN11. Previously, IPSAS 13 contained a choice on how to account for such costs – they might be either charged as an expense as incurred or allocated over the lease term and the choice of treatment applied to both operating and finance leases.

## IPSAS 13—LEASES

### Objective

1. The objective of this Standard is to prescribe, for lessees and lessors, the appropriate accounting policies and disclosures to apply in relation to finance and operating leases.

### Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for all leases other than:**
  - (a) **Leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources; and**
  - (b) **Licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights.**

**However, this Standard shall not be applied as the basis of measurement for:**

- (a) **Property held by Lessees that is accounted for as investment property (see International Public Sector Accounting Standard IPSAS 16, “Investment Property”);**
  - (b) **Investment property provided by lessors under operating leases (see IPSAS 16);**
  - (c) **Biological assets held by lessees under finance leases (see the relevant international or national accounting standard dealing with agriculture); or**
  - (d) **Biological assets provided by lessors under operating leases (see the relevant international or national accounting standard dealing with agriculture).**
3. **This Standard applies to all public sector entities other than Government Business Enterprises.**
  4. This Standard applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This Standard does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other. Public sector entities may enter into complex arrangements for the delivery of services, which may or may not include leases of assets. These arrangements are discussed in paragraphs 25 to 27.

5. This Standard does not apply to lease agreements to explore for or use natural resources such as oil, gas, timber, metals and other mineral rights, and licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights. This is because these types of agreements have the potential to raise complex accounting issues which need to be addressed separately.
6. This Standard does not apply to investment property. Investment properties are measured by lessors and lessees in accordance with the provisions of IPSAS 16.
7. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”

## Definitions

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

**The commencement of the lease term** is the date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e. the recognition of the assets, liabilities, revenue or expenses resulting from the lease, as appropriate).

**Contingent rent** is that portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than the passage of time (e.g., percentage of future sales, amount of future use, future price indices, future market rates of interest).

**Economic life** is either:

- (a) The period over which an asset is expected to yield economic benefits or service potential to one or more users; or
- (b) The number of production or similar units expected to be obtained from the asset by one or more users.

**Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

A **finance lease** is a lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.

**Gross investment in the lease** is the aggregate of:

- (a) The minimum lease payments receivable by the lessor under a finance lease; and
- (b) Any unguaranteed residual value accruing to the lessor.

**Guaranteed residual value is:**

- (c) For a lessee, that part of the residual value that is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and
- (d) For a lessor, that part of the residual value that is guaranteed by the lessee or by a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

The **inception of the lease** is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date:

- (a) A lease is classified as either an operating or a finance lease; and
- (b) In the case of a finance lease, the amounts to be recognized at the commencement of the lease term are determined.

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

The **interest rate implicit in the lease** is the discount rate that, at the inception of the lease, causes the aggregate present value of:

- (a) The minimum lease payments; and
- (b) The unguaranteed residual value

to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct costs of the lessor.

A **lease** is an agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.

The **lease term** is the non-cancelable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when at the inception of the lease it is reasonably certain that the lessee will exercise the option.

The **lessee's incremental borrowing rate of interest** is the rate of interest the lessee would have to pay on a similar lease or, if that is not

determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.

**Minimum lease payments** are the payments over the lease term that the lessee is, or can be, required to make, excluding contingent rent, costs for services and, where appropriate, taxes to be paid by and reimbursed to the lessor, together with:

- (a) For a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or
- (b) For a lessor, any residual value guaranteed to the lessor by:
  - (i) The lessee;
  - (ii) A party related to the lessee; or
  - (iii) An independent third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.

However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.

**Net investment in the lease** is the gross investment in the lease discounted at the interest rate implicit in the lease.

A **non-cancelable lease** is a lease that is cancelable only:

- (a) Upon the occurrence of some remote contingency;
- (b) With the permission of the lessor;
- (c) If the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or
- (d) Upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.

An **operating lease** is a lease other than a finance lease.

**Unearned finance revenue** is the difference between:

- (a) The gross investment in the lease; and
- (b) The net investment in the lease.

**Unguaranteed residual value** is that portion of the residual value of the leased asset, the realization of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.

**Useful life** is the estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity.

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

#### **Changes in Lease Payments between the Inception of the Lease and the Commencement of the Lease Term**

9. A lease agreement or commitment may include a provision to adjust the lease payments for changes in the construction or acquisition cost of the leased property or for changes in some other measure of cost or value, such as general price levels, or in the lessor's costs of financing the lease, during the period between the inception of the lease and the commencement of the lease term. If so, the effect of any such changes shall be deemed to have taken place at the inception of the lease for the purposes of this Standard.

#### **Hire Purchase Contracts**

10. The definition of a lease includes contracts for the hire of an asset which contain a provision giving the hirer an option to acquire title to the asset upon the fulfillment of agreed conditions. These contracts are sometimes known as hire purchase contracts.

#### **Incremental Borrowing Rate of Interest**

11. Where an entity has borrowings which are guaranteed by the government, the determination of the lessee's incremental borrowing rate of interest reflects the existence of any government guarantee and any related fees. This will normally lead to the use of a lower incremental borrowing rate of interest.

#### **Classification of Leases**

12. The classification of leases adopted in this Standard is based on the extent to which risks and rewards incidental to ownership of a leased asset lie with the lessor or the lessee. Risks include the possibilities of losses from idle capacity, technological obsolescence or changes in value because of changing economic conditions. Rewards may be represented by the expectation of service potential or profitable operation over the asset's economic life and of gain from appreciation in value or realization of a residual value.

13. **A lease is classified as a finance lease if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an operating lease if it does not transfer substantially all the risks and rewards incidental to ownership.**
14. Because the transaction between a lessor and a lessee is based on a lease agreement between them, it is appropriate to use consistent definitions. The application of these definitions to the differing circumstances of the lessor and lessee may result in the same lease being classified differently by them. For example, this may be the case if the lessor benefits from a residual value guarantee provided by a party unrelated to the lessee.
15. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Although the following are examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease, a lease does not need to meet all these criteria in order to be classified as a finance lease:
- (a) The lease transfers ownership of the asset to the lessee by the end of the lease term;
  - (b) The lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised;
  - (c) The lease term is for the major part of the economic life of the asset even if title is not transferred;
  - (d) At the inception of the lease the present value of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset;
  - (e) The leased assets are of such a specialized nature that only the lessee can use them without major modifications; and
  - (f) The leased assets cannot easily be replaced by another asset.
16. Other indicators that individually or in combination could also lead to a lease being classified as a finance lease are:
- (a) If the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;
  - (b) Gains or losses from the fluctuation in the fair value of the residual accrue to the lessee (for example in the form of a rent rebate equaling most of the sales proceeds at the end of the lease); and
  - (c) The lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

17. The examples and indicators in paragraphs 15 and 16 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset transfers at the end of the lease for a variable payment equal to its then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all such risks and rewards.
18. Lease classification is made at the inception of the lease. If at any time the lessee and the lessor agree to change the provisions of the lease, other than by renewing the lease, in a manner that would have resulted in a different classification of the lease under the criteria in paragraphs 12 to 17 if the changed terms had been in effect at the inception of the lease, the revised agreement is regarded as a new agreement over its term. However, changes in estimates (for example, changes in estimates of the economic life or the residual value of the leased property) or changes in circumstances (for example, default by the lessee), do not give rise to a new classification of a lease for accounting purposes.
19. Leases of land and buildings are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the lessee by the end of the lease term, the lessee normally does not receive substantially all of the risks and rewards incidental to ownership, in which case the lease of land will be an operating lease. A payment made on entering into or acquiring a leasehold that is accounted for as an operating lease represents pre-paid lease payments that are amortized over the lease term in accordance with the pattern of benefits provided.
20. The land and buildings elements of a lease of land and buildings are considered separately for the purposes of lease classification. If title to both elements is expected to pass to the lessee by the end of the lease term, both elements are classified as a finance lease, whether analyzed as one lease or as two leases, unless it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership of one or both elements. When the land has an indefinite economic life, the land element is normally classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term, in accordance with paragraph 19. The buildings element is classified as a finance or operating lease in accordance with paragraphs 12-18.
21. Whenever necessary in order to classify and account for a lease of land and buildings, the minimum lease payments (including any lump-sum upfront payments) are allocated between the land and the buildings elements in proportion to the relative fair values of the leasehold interests in the land element and buildings element of the lease at the inception of the lease. If the lease payments cannot be allocated reliably between these two elements,

the entire lease is classified as a finance lease, unless it is clear that both elements are operating leases, in which case the entire lease is classified as an operating lease.

22. For a lease of land and buildings in which the amount that would initially be recognized for the land element, in accordance with paragraph 28, is immaterial, the land and buildings may be treated as a single unit for the purpose of lease classification and classified as a finance or operating lease in accordance with paragraphs 12-18. In such a case, the economic life of the buildings is regarded as the economic life of the entire leased asset.
23. Separate measurement of the land and buildings elements is not required when the lessee's interest in both land and buildings is classified as an investment property in accordance with IPSAS 16 and the fair value model is adopted. Detailed calculations are required for this assessment only if the classification of one or both elements is otherwise uncertain.
24. In accordance with IPSAS 16, it is possible for a lessee to classify a property interest held under an operating lease as an investment property. If it does, the property interest is accounted for as if it were a finance lease and, in addition, the fair value model is used for the asset recognized. The lessee shall continue to account for the lease as a finance lease, even if a subsequent event changes the nature of the lessee's property interest so that it is no longer classified as investment property. This will be the case if, for example, the lessee:
  - (a) Occupies the property, which is then transferred to owner-occupied property at a deemed cost equal to its fair value at the date of change in use; or
  - (b) Grants a sublease that transfers substantially all of the risks and rewards incidental to ownership of the interest to an unrelated third party. Such a sublease is accounted for by the lessee as a finance lease to the third party, although it may be accounted for as an operating lease by the third party.

### **Leases and Other Contracts**

25. A contract may consist solely of an agreement to lease an asset. However, a lease may also be one element in a broader set of agreements with private sector entities to construct, own, operate and/or transfer assets. Public sector entities often enter into such agreements, particularly in relation to long-lived physical assets and infrastructure assets. For example, a public sector entity may construct a tollway. It may then lease the tollway to a private sector entity as part of an arrangement whereby the private sector entity agrees to:
  - (a) Lease the tollway for an extended period of time (with or without an option to purchase the facility);

- (b) Operate the tollway; and
- (c) Fulfill extensive maintenance requirements, including regular upgrading of both the road surface and the traffic control technology.

Other agreements may involve a public sector entity leasing infrastructure from the private sector.

- 26. Where an arrangement contains an identifiable operating lease or finance lease as defined in this Standard, the provisions of this Standard are applied in accounting for the lease component of the arrangement.
- 27. Public sector entities may also enter a variety of agreements for the provision of goods and/or services, which necessarily involve the use of dedicated assets. In some of these agreements, it may not be clear whether or not a lease, as defined by this Standard, has arisen. In these cases, professional judgment is exercised, and if a lease has arisen this standard is applied; and if a lease has not arisen entities account for those agreements by applying the provisions of other relevant International Public Sector Accounting Standards, or in the absence thereof, other relevant international and/or national accounting standards.

## Leases in the Financial Statements of Lessees

### Finance Leases

- 28. **At the commencement of the lease term lessees shall recognize assets acquired under finance leases as assets and the associated lease obligations as liabilities in their statements of financial position. The assets and liabilities shall be recognized at amounts equal to the fair value of the leased property or, if lower, the present value of the minimum lease payments, each determined at the inception of the lease. The discount rate to be used in calculating the present value of the minimum lease payments is the interest rate implicit in the lease, if this is practicable to determine; if not, the lessee's incremental borrowing rate shall be used.**
- 29. Transactions and other events are accounted for and presented in accordance with their substance and financial reality and not merely with legal form. Although the legal form of a lease agreement is that the lessee may acquire no legal title to the leased asset, in the case of finance leases the substance and financial reality are that the lessee acquires the economic benefits or service potential of the use of the leased asset for the major part of its economic life in return for entering into an obligation to pay for that right an amount approximating, at the inception of the lease, the fair value of the asset and the related finance charge.
- 30. If such lease transactions are not reflected in the lessee's financial statements, the assets and liabilities of an entity are understated, thereby

distorting financial ratios. Therefore, it is appropriate for a finance lease to be recognized in the lessee's financial statements both as an asset and as an obligation to pay future lease payments. At the commencement of the lease term, the asset and the liability for the future lease payments are recognized in the financial statements at the same amounts except for any initial direct costs of the lessee that are added to the amount recognized as an asset.

31. It is not appropriate for the liabilities for leased assets to be presented in the financial statements as a deduction from the leased assets.
32. If for the presentation of liabilities on the face of the statement of financial position a distinction is made between current and non-current liabilities, the same distinction is made for lease liabilities.
33. Initial direct costs are often incurred in connection with specific leasing activities, such as negotiating and securing leasing arrangements. The costs identified as directly attributable to activities performed by the lessee for a finance lease are added to the amount recognized as an asset.
34. **Minimum lease payments shall be apportioned between the finance charge and the reduction of the outstanding liability. The finance charge shall be allocated to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. Contingent rents shall be charged as expenses in the periods in which they are incurred.**
35. In practice, in allocating the finance charge to periods during the lease term, a lessee may use some form of approximation to simplify the calculation.
36. **A finance lease gives rise to a depreciation expense for depreciable assets as well as a finance expense for each accounting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognized shall be calculated in accordance with International Public Sector Accounting Standard (IPSAS) 17, "Property, Plant and Equipment" and any international and/or national accounting standard on intangible assets which has been adopted by the entity. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term or its useful life.**
37. The depreciable amount of a leased asset is allocated to each accounting period during the period of expected use on a systematic basis consistent with the depreciation policy the lessee adopts for depreciable assets that are owned. If there is reasonable certainty that the lessee will obtain ownership by the end of the lease term, the period of expected use is the useful life of the asset; otherwise the asset is depreciated over the shorter of the lease term or its useful life.

38. The sum of the depreciation expense for the asset and the finance expense for the period is rarely the same as the lease payments payable for the period, and it is therefore inappropriate simply to recognize the lease payments payable as an expense. Accordingly, the asset and the related liability are unlikely to be equal in amount after the commencement of the lease term.
39. To determine whether a leased asset has become impaired an entity applies relevant impairment tests in international and/or national accounting standards.
40. **Lessees shall disclose the following for finance leases:**
- (a) **For each class of asset, the net carrying amount at the reporting date;**
  - (b) **A reconciliation between the total of future minimum lease payments at the reporting date, and their present value;**
  - (c) **In addition, an entity shall disclose the total of future minimum lease payments at the reporting date, and their present value, for each of the following periods:**
    - (i) **Not later than one year;**
    - (ii) **Later than one year and not later than five years; and**
    - (iii) **Later than five years;**
  - (d) **Contingent rents recognized as an expense in the period;**
  - (e) **The total of future minimum sublease payments expected to be received under non-cancelable subleases at the reporting date; and**
  - (f) **A general description of the lessee's material leasing arrangements including, but not limited to, the following:**
    - (i) **The basis on which contingent rent payable is determined;**
    - (ii) **The existence and terms of renewal or purchase options and escalation clauses; and**
    - (iii) **Restrictions imposed by lease arrangements, such as those concerning return of net surplus, return of capital contributions, dividends, additional debt and further leasing.**
41. In addition, the requirements for disclosure in accordance with IPSAS 16, IPSAS 17, IPSAS 21 and any international and/or national accounting standard on intangible assets and on impairment of cash-generating assets which have been adopted by the entity are applied to the amounts of leased

assets under finance leases that are accounted for by the lessee as acquisitions of assets.

### Operating Leases

42. **Lease payments under an operating lease shall be recognized as an expense on a straight line basis over the lease term unless another systematic basis is representative of the time pattern of the user's benefit.**
43. For operating leases, lease payments (excluding costs for services such as insurance and maintenance) are recognized as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.
44. **Lessees shall disclose the disclosures for operating leases:**
  - (a) **The total of future minimum lease payments under non-cancelable operating leases for each of the following periods:**
    - (i) **Not later than one year;**
    - (ii) **Later than one year and not later than five years; and**
    - (iii) **Later than five years;**
  - (b) **The total of future minimum sublease payments expected to be received under non-cancelable subleases at the reporting date;**
  - (c) **Lease and sublease payments recognized as an expense in the period, with separate amounts for minimum lease payments, contingent rents, and sublease payments; and**
  - (d) **A general description of the lessee's significant leasing arrangements including, but not limited to, the following:**
    - (i) **The basis on which contingent rent payments are determined;**
    - (ii) **The existence and terms of renewal or purchase options and escalation clauses; and**
    - (iii) **Restrictions imposed by lease arrangements, such as those concerning return of net surplus, return of capital contributions, dividends, additional debt, and further leasing.**

## Leases in the Financial Statements of Lessors

### Finance Leases

45. This Standard describes the treatment of finance revenue earned under finance leases. The term “manufacturer or trader lessor” is used in this Standard to refer to all public sector entities that manufacture or trade assets and also act as lessors of those assets, regardless of the scale of their leasing, trading and manufacturing activities. With respect to an entity that is a manufacturer or trader lessor, the Standard also describes the treatment of gains or losses arising from the transfer of assets.
46. Public sector entities may enter into finance leases as a lessor under a variety of circumstances. Some public sector entities may trade assets on a regular basis. For example, governments may create special purpose entities that are responsible for the central procurement of assets and supplies for all other entities. Centralization of the purchasing function may provide greater opportunity to obtain trade discounts or other favorable conditions. In some jurisdictions, a central purchasing entity may purchase items on behalf of other entities, with all transactions being conducted in the name of the other entities. In other jurisdictions, a central purchasing entity may purchase items in its own name and its functions may include:
- (a) Procuring assets and supplies;
  - (b) Transferring assets by way of sale or finance lease; and/or
  - (c) Managing a portfolio of assets, such as a motor vehicle fleet, for use by other entities and making those assets available for short or long-term lease, or purchase.
47. Other public sector entities may enter into lease transactions on a more limited scale and at less frequent intervals. In particular, in some jurisdictions public sector entities which have traditionally owned and operated infrastructure assets such as roads, dams, and water treatment plants are no longer automatically assuming complete ownership and operational responsibility for these assets. Public sector entities may transfer existing infrastructure assets to private sector entities by way of sale or by way of finance lease. In addition, public sector entities may construct new long-lived physical and infrastructure assets in partnership with private sector entities with the intention that the private sector entity will assume responsibility for the assets by way of outright purchase or by way of finance lease once they are completed. In some cases, the arrangement provides for a period of control by the private sector before reversion of title and control of the asset to the public sector — for example, a local government may build a hospital and lease the facility to a private sector company for a period of twenty years, after which time the facility reverts to public control.

48. **Lessors shall recognize lease payments receivable under a finance lease as assets in their statements of financial position. They shall present such assets as a receivable at an amount equal to the net investment in the lease.**
49. Under a finance lease, substantially all the risks and rewards incidental to legal ownership are transferred by the lessor, and thus the lease payment receivable is treated by the lessor as repayment of principal and finance revenue to reimburse and reward the lessor for its investment and services.

#### **Initial Recognition**

50. Initial direct costs are often incurred by lessors and include amounts such as commissions, legal fees and internal costs that are incremental and directly attributable to negotiating and arranging a lease. They exclude general overheads such as those incurred by a sales and marketing team. For finance leases other than those involving manufacturer or trader lessors, initial direct costs are included in the initial measurement of the finance lease receivable and reduce the amount of revenue recognized over the lease term. The interest rate implicit in the lease is defined in such a way that the initial direct costs are included automatically in the finance lease receivable; there is no need to add them separately. Costs incurred by manufacturer or trader lessors in connection with negotiating and arranging a lease are excluded from the definition of initial direct costs. As a result, they are excluded from the net investment in the lease and are recognized as an expense when the gain or loss on sale is recognized, which for a finance lease is normally at the commencement of the lease term.
51. **The recognition of finance revenue shall be based on a pattern reflecting a constant periodic rate of return on the lessor's net investment in the finance lease.**
52. A lessor aims to allocate finance revenue over the lease term on a systematic and rational basis. This revenue allocation is based on a pattern reflecting a constant periodic return on the lessor's net investment in the finance lease. Lease payments relating to the accounting period, excluding costs for services, are applied against the gross investment in the lease to reduce both the principal and the unearned finance revenue.
53. Estimated unguaranteed residual values used in computing the lessor's gross investment in a lease are reviewed regularly. If there has been a reduction in the estimated unguaranteed residual value, the revenue allocation over the lease term is revised and any reduction in respect of amounts already accrued is recognized immediately.
54. **Manufacturer or trader lessors shall recognize gains or losses on sale of assets in the period, in accordance with the policy followed by the entity for outright sales.**

55. **If artificially low rates of interest are quoted, any gains or losses on sale of assets shall be restricted to that which would apply if a market rate of interest were charged. Costs incurred by manufacturer or trader lessors in connection with negotiating and arranging a lease shall be recognized as an expense when the gain or loss is recognized.**
56. Public sector entities which manufacture or trade assets may offer to potential purchasers the choice of either buying or leasing an asset. A finance lease of an asset by a manufacturer or trader lessor gives rise to two types of revenue:
- (a) The gain or loss equivalent to the gain or loss resulting from an outright sale of the asset being leased, at normal selling prices, reflecting any applicable volume or trade discounts; and
  - (b) The finance revenue over the lease term.
57. The sales revenue recognized at the commencement of the lease term by a manufacturer or trader lessor is the fair value of the asset, or, if lower, the present value of the minimum lease payments accruing to the lessor, computed at a commercial rate of interest. The cost of sale of an asset recognized at the commencement of the lease term is the cost, or carrying amount if different, of the leased property less the present value of the unguaranteed residual value. The difference between the sales revenue and the cost of sale is the gain or loss on sale which is recognized in accordance with the entity's policy for outright sales.
58. Manufacturer or trader lessors may sometimes offer customers lower rates of interest than their normal lending rates. The use of such a rate would result in an excessive portion of the total revenue from the transaction being recognized at the time of sale. If artificially low rates of interest are quoted, revenue recognized as gain or loss on sale is restricted to that which would apply if the entity's normal lending rate for that type of transaction were charged.
59. Initial direct costs are recognized as an expense at the commencement of the lease term because they are mainly related to earning the manufacturer's or trader's gain or loss on sale.
60. **Lessors shall disclose the following for finance leases:**
- (a) **A reconciliation between the total gross investment in the lease at the reporting date, and the present value of minimum lease payments receivable at the reporting date. In addition, an entity shall disclose the gross investment in the lease and the present value of minimum lease payments receivable at the reporting date, for each of the following periods:**
    - (i) **Not later than one year;**

- (ii) **Later than one year and not later than five years; and**
  - (iii) **Later than five years;**
  - (b) **Unearned finance revenue;**
  - (c) **The unguaranteed residual values accruing to the benefit of the lessor;**
  - (d) **The accumulated allowance for uncollectible minimum lease payments receivable;**
  - (e) **Contingent rents recognized in the statement of financial performance; and**
  - (f) **A general description of the lessor's material leasing arrangements.**
61. As an indicator of growth in leasing activities it is often useful to also disclose the gross investment less unearned revenue in new business added during the accounting period, after deducting the relevant amounts for canceled leases.

#### **Operating Leases**

62. **Lessors shall present assets subject to operating leases in their statements of financial position according to the nature of the asset.**
63. **Lease revenue from operating leases shall be recognized as revenue on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which benefits derived from the leased asset is diminished.**
64. Costs, including depreciation, incurred in earning the lease revenue are recognized as an expense. Lease revenue (excluding receipts for services provided such as insurance and maintenance) is recognized as revenue on a straight line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.
65. **Initial direct costs incurred by lessors in negotiating and arranging an operating lease shall be added to the carrying amount of the leased asset and recognized as an expense over the lease term on the same basis as the lease revenue.**
66. **The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets, and depreciation shall be calculated in accordance with IPSAS 17, and any international and/or national accounting standard on intangible assets that has been adopted by the entity.**

67. To determine whether a leased asset has become impaired, an entity applies relevant impairment tests in international and/or national accounting standards.
68. A manufacturer or trader lessor does not recognize any gain on sale on entering into an operating lease because it is not the equivalent of a sale.
69. **Lessors shall disclose the following for operating leases:**
- (a) **The future minimum lease payments under non-cancelable operating leases in the aggregate and for each of the following periods:**
    - (i) **Not later than one year;**
    - (ii) **Later than one year and not later than five years; and**
    - (iii) **Later than five years;**
  - (b) **Total contingent rents recognized in the statement of financial performance in the period; and**
  - (c) **A general description of the lessor's leasing arrangements.**

### **Sale and Leaseback Transactions**

70. A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends upon the type of lease involved.
71. **If a sale and leaseback transaction results in a finance lease, any excess of sales proceeds over the carrying amount shall not be immediately recognized as revenue by a seller-lessee. Instead, it shall be deferred and amortized over the lease term.**
72. If the leaseback is a finance lease, the transaction is a means whereby the lessor provides finance to the lessee, with the asset as security. For this reason it is not appropriate to regard an excess of sales proceeds over the carrying amount as revenue. Such excess is deferred and amortized over the lease term.
73. **If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at fair value, any gain or loss shall be recognized immediately. If the sale price is below fair value, any gain or loss shall be recognized immediately except that, if the loss is compensated by future lease payments at below market price, it shall be deferred and amortized in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is**

**above fair value, the excess over fair value shall be deferred and amortized over the period for which the asset is expected to be used.**

74. If the leaseback is an operating lease, and the lease payments and the sale price are at fair value, there has in effect been a normal sale transaction and any gain or loss is recognized immediately.
75. **For operating leases, if the fair value at the time of a sale and leaseback transaction is less than the carrying amount of the asset, a loss equal to the amount of the difference between the carrying amount and fair value shall be recognized immediately.**
76. For finance leases, no such adjustment is necessary unless there has been an impairment in value and that impairment is required to be recognized by any international and/or national accounting standard on impairment which has been adopted by the entity.
77. Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of the material leasing arrangements leads to disclosure of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.
78. Sale and leaseback transactions may be required to be separately disclosed in accordance with IPSAS 1, "Presentation of Financial Statements."

### **Transitional Provisions**

79. **All provisions of this Standard shall be applied from the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards, except in relation to leased assets which have not been recognized as a result of transitional provisions under another International Public Sector Accounting Standard. The provisions of this Standard would not be required to apply to such assets until the transitional provision in the other International Public Sector Accounting Standard expires. In no case shall the existence of transitional provisions in other Standards preclude the full application of accrual accounting in accordance with International Public Sector Accounting Standards.**
80. Notwithstanding the existence of transitional provisions under another International Public Sector Accounting Standard, entities that are in the process of adopting the accrual basis of accounting are encouraged to comply in full with the provisions of that other Standard as soon as possible.
81. **Subject to paragraph 83, retrospective application of this Standard by entities that have already adopted the accrual basis of accounting and that intend to comply with International Public Sector Accounting Standards as they are issued is encouraged but not required. If the Standard is not applied retrospectively, the balance of any pre-existing**

**finance lease is deemed to have been properly determined by the lessor and shall be accounted for thereafter in accordance with the provisions of this Standard.**

82. Entities that have already adopted the accrual basis of accounting and that intend to comply with International Public Sector Accounting Standards as they are issued, may have pre-existing finance leases that have been recognized as assets and liabilities in the statement of financial position. Retrospective application of this Standard to existing finance leases is encouraged. Retrospective application could lead to the restatement of such assets and liabilities. Such assets and liabilities are required to be restated only if the Standard is applied retrospectively.
- 83. An entity that has previously applied IPSAS 13 (2001) shall apply the amendments made by this Standard retrospectively for all leases that it has recognized in accordance with that Standard or, if IPSAS 13 (2001) was not applied retrospectively, for all leases entered into since it first applied that Standard and recognized in accordance with that Standard.**
84. Transitional provisions in IPSAS 13 (2001) provide entities with a period of up to five years to recognize all leases from the date of its first application. Entities that have previously applied IPSAS 13 (2001) may continue to take advantage of this five-year transitional period from the date of first application of IPSAS 13 (2001).

### **Effective Date**

- 85. An entity shall apply this International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
86. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

### **Withdrawal of IPSAS 13 (2001)**

87. This Standard supersedes IPSAS 13, "Leases" issued in 2001.

## Implementation Guidance 1—Classification of a Lease

*This guidance accompanies, but is not part of, IPSAS 13.*

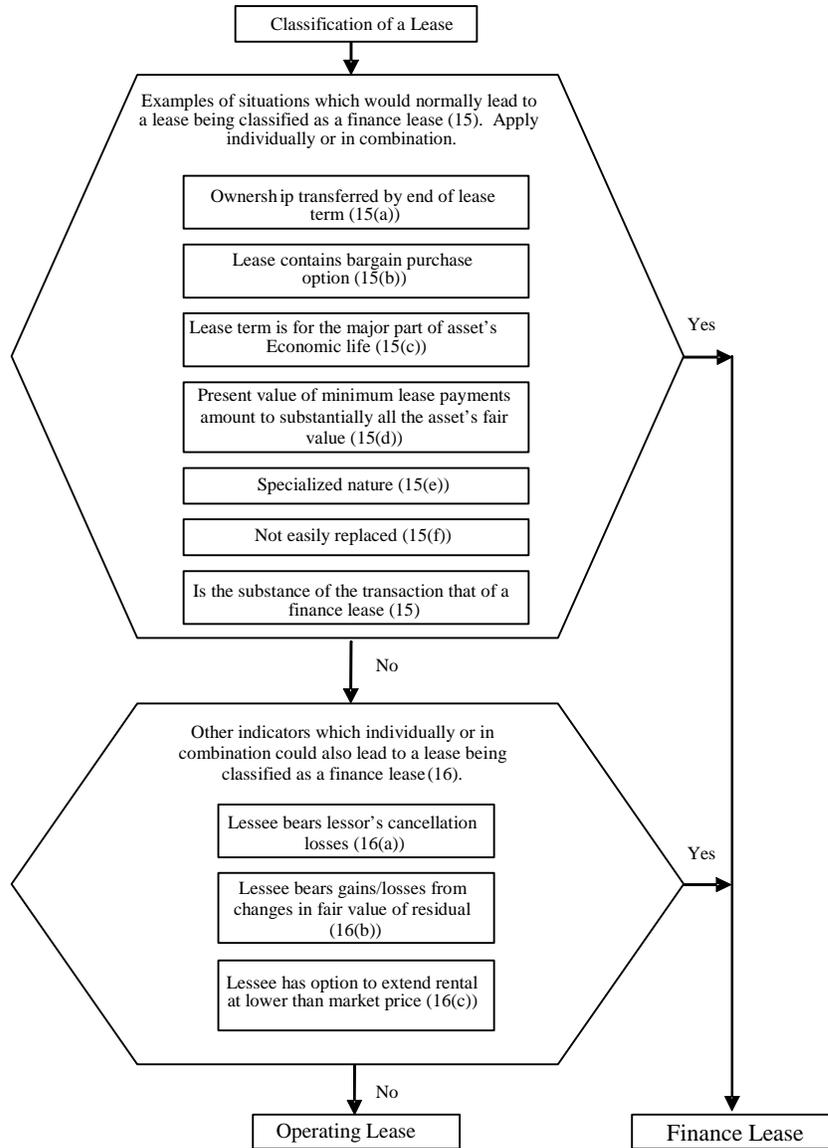
The appendix is illustrative only and does not form part of the standards, it should however be interpreted in the context of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

The objective of the chart on the next page is to assist in classifying a lease as either a finance lease or an operating lease. A finance lease is a lease that transfers substantially all the risks and rewards incident to ownership of an asset. An operating lease is a lease other than a finance lease.

The examples contained in this chart do not necessarily reflect all possible situations in which a lease may be classified as a finance lease, nor should a lease necessarily be classified as a finance lease by virtue of the route followed in this chart. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract (paragraph 15).

In the flowchart, the numbers in parentheses refer to paragraph numbers in the Standard.

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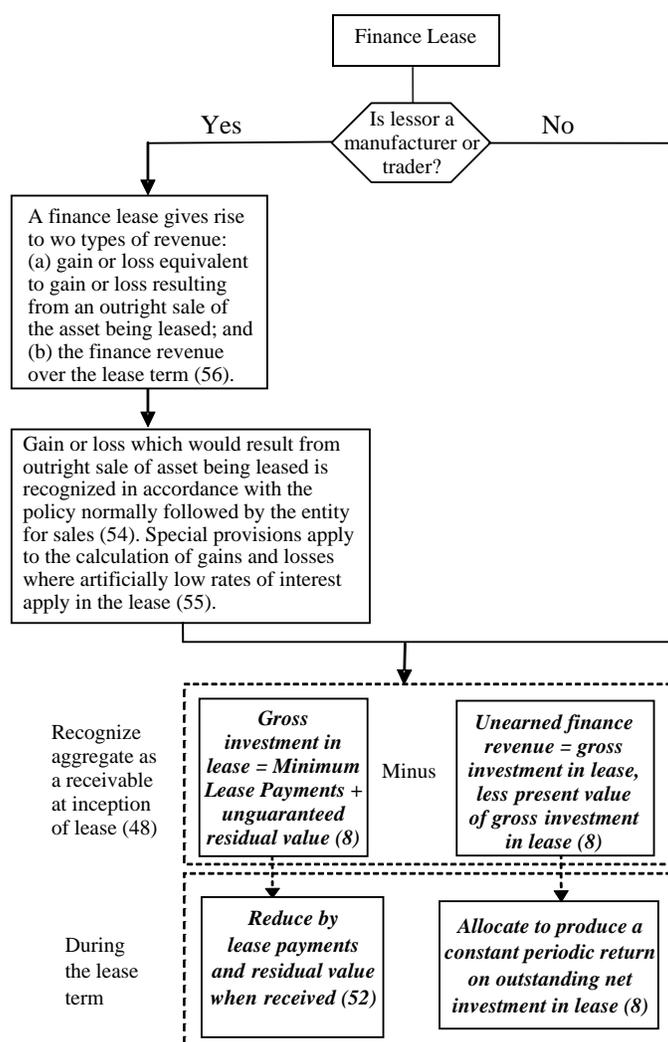


## Implementation Guidance 2—Accounting for a Finance Lease by a Lessor

*This guidance accompanies, but is not part of, IPSAS 13.*

The appendix is illustrative only and does not form part of the standards, it should however be interpreted in the context of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

In the flowchart, the numbers in parentheses refer to paragraph numbers in the Standard.

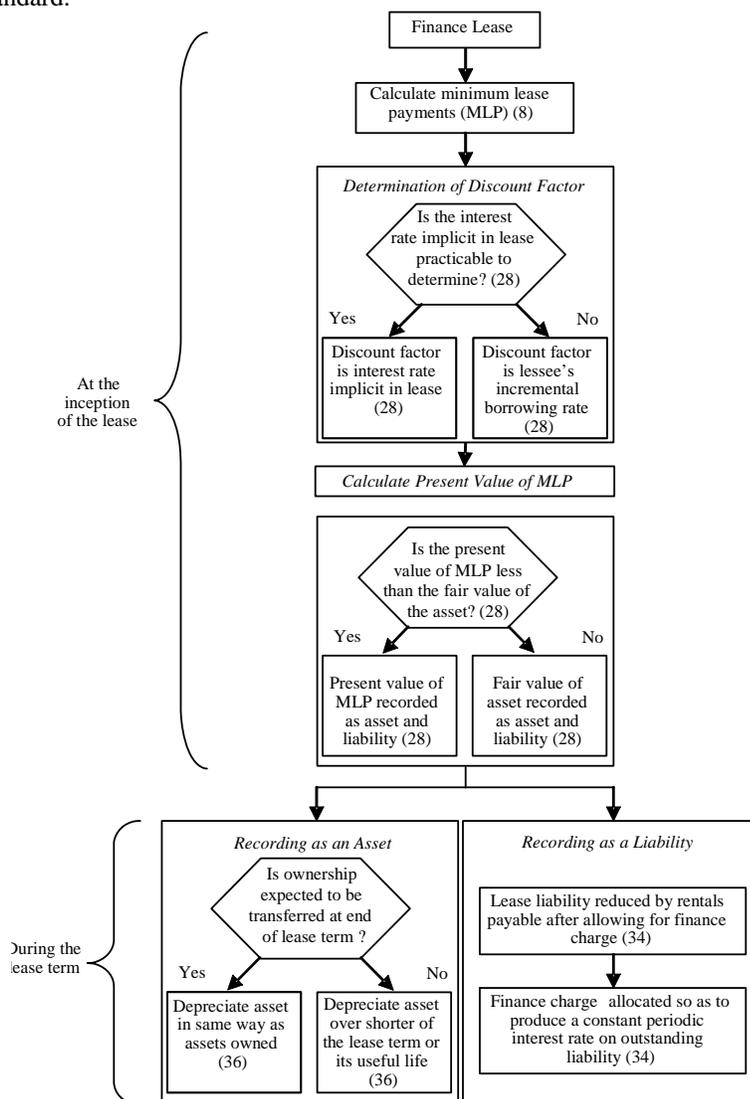


### Implementation Guidance 3—Accounting for a Finance Lease by a Lessee

*This guidance accompanies, but is not part of, IPSAS 13.*

The appendix is illustrative only and does not form part of the standards, it should however be interpreted in the context of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

In the flowchart, the numbers in parentheses refer to paragraph numbers in the Standard.



## Implementation Guidance 4—Sale and Leaseback Transactions that Result in Operating Leases

*This guidance accompanies, but is not part of, IPSAS 13.*

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

A sale and leaseback transaction that results in an operating lease may give rise to a gain or a loss, the determination and treatment of which depends upon the leased asset's carrying amount, fair value and selling price. The table on the following page shows the requirements of the Standard in various circumstances.

Sale price established at fair value (paragraph 65)	Carrying amount equal to fair value	Carrying amount less than fair value	Carrying amount above fair value
<b>Gain</b>	no gain	recognize gain immediately	no gain
<b>Loss</b>	no loss	no loss	recognize loss immediately

Sale price below fair value (paragraph 65)	Carrying amount equal to fair value	Carrying amount less than fair value	Carrying amount above fair value
<b>Gain</b>	no gain	recognize gain immediately	no gain (note 1)
<b>Loss <u>not</u> compensated by future lease payments at below market price</b>	recognize loss immediately	recognize loss immediately	(note 1)
<b>Loss compensated by future lease payments at below market price</b>	defer and amortize loss	defer and amortize loss	(note 1)

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<b>Sale price above fair value</b> (paragraph 65)	<b>Carrying amount equal to fair value</b>	<b>Carrying amount less than fair value</b>	<b>Carrying amount above fair value</b>
<b>Gain</b>	defer and amortize gain	defer and amortize gain (note 2)	defer and amortize gain (note 3)
<b>Loss</b>	no loss	no loss	(note 1)

Note 1 These parts of the table represent circumstances that would have been dealt with under paragraph 75 of the Standard. Paragraph 75 requires the carrying amount of an asset to be written down to fair value where it is subject to a sale and leaseback.

Note 2 If the sale price is above fair value, the excess over fair value should be deferred and amortized over the period for which the asset is expected to be used (paragraph 73).

Note 3 The gain would be the difference between fair value and sale price as the carrying amount would have been written down to fair value in accordance with paragraph 75.

## Implementation Guidance 5—Calculating the Interest Rate Implicit in a Finance Lease

*This guidance accompanies, but is not part of, IPSAS 13.*

The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

The Standard (paragraph 28) requires the lessees of assets acquired under finance leases to calculate the interest rate implicit in a lease, where practical. Paragraph 34 requires the lessees to apportion lease payments between the finance charge and the reduction of the outstanding liability using the interest rate implicit in the lease. Many lease agreements explicitly identify the interest rate implicit in the lease, but some do not. If a lease agreement does not identify the interest rate implicit in the lease the lessee needs to calculate the rate, using the present value formula. Financial calculators and spreadsheets will automatically calculate the interest rate implicit in a lease. Where these are not available, entities can use the present value formula to manually calculate the rate. This appendix illustrates the following two common methods for calculating the interest rate: trial and error, and interpolation. Both methods use the present value formula to derive the interest rate.

Derivations of present value formulas are widely available in accounting and finance textbooks. The present value (PV) of minimum lease payments (MLP) is calculated by means of the following formula:

$$PV(MLP) = \frac{S}{(1+r)^n} + \frac{A}{r} \left[ 1 - \frac{1}{(1+r)^n} \right]$$

Where:

“S” is the guaranteed residual value

“A” is the regular periodical payment

“r” is the periodic interest rate implicit in the lease expressed as a decimal

“n” is the number of periods in the term of the lease

### Example

Department X enters into an agreement to acquire a motor vehicle on a finance lease. The fair value of the motor vehicle at the inception of the lease is 25,000 currency units, the annual lease payments are 5,429 currency units payable in arrears, the lease term is four years, and the guaranteed residual value is 10,000 currency units. The lease agreement does not provide any services additional to the supply of the motor vehicle. Department X is responsible for all the running costs of the vehicle including insurance, fuel and maintenance. The lease agreement does not specify the interest rate implicit in the lease. The Department’s incremental borrowing rate is 7%

per annum. Several financial institutions are advertising loans secured by motor vehicles at rates varying between 7.5% and 10%.

### **Trial and Error Method**

The calculation is an iterative process — that is, the lessee must make a “best guess” of the interest rate and calculate the present value of the minimum lease payments and compare the result to the fair value of the leased asset at the inception of the lease. If the result is less than the fair value, the interest rate selected was too high, if the result is greater than the fair value, the interest rate selected was too low. The interest rate implicit in a lease is the rate used when the present value of the minimum lease payments is equal to the fair value of the leased asset at the inception of the lease.

The Department X would begin calculations using a best estimate — for example its incremental borrowing rate of 7% per annum, which is too low. It would then use the maximum feasible rate — for example the 10% per annum rate offered for loans secured by a motor vehicle, which would prove too high. After several calculations it would arrive at the correct rate of 8.5% per annum.

To calculate the interest rate the Department uses the PV(MLP) formula above, where:

$S = 10,000$     $n = 4$     $r =$  Annual interest rate expressed as a decimal

$A = 5,429$    Target PV(MLP) = 25,000

At Department X’s incremental borrowing rate of 7% (0.07) per annum (figures are rounded):

$$\begin{aligned} \text{PV(MLP)} &= \frac{10,000}{(1+0.07)^4} + \frac{5,429}{0.07} \left[ 1 - \frac{1}{(1+0.07)^4} \right] \\ &= 7,629 + 18,390 \\ &= 26,019 \end{aligned}$$

The PV(MLP) using the incremental borrowing rate is greater than the fair value of the leased asset, therefore a higher rate is implicit in the lease. The Department must make calculations at other rates to determine the actual rate (figures are rounded):

PV(MLP) at 7.5%	= 25,673	Interest rate too low
PV(MLP) at 10%	= 24,040	Interest rate too high
PV(MLP) at 9%	= 24,674	Interest rate too high
PV(MLP) at 8%	= 25,333	Interest rate too low
PV(MLP) at 8.5%	= 25,000	Correct interest rate

The Department will now use the interest rate of 8.5% to apportion the lease payments between the finance charge and the reduction of the lease liability, as shown in the table below.

### Interpolation Method

Calculating the interest rate implicit in a lease requires lessees to initially calculate the present value for an interest rate that is too high, and one that is too low. The differences (in absolute terms) between the results obtained and the actual net present value are used to interpolate the correct interest rate. Using the data provided above, and the results for 7% and 10%, the actual rate can be interpolated as follows (figures are rounded):

PV at 7% = 26,019, difference = 1,019 (i.e., 26,019 – 25,000)

PV at 10% = 24,040, difference = 960 (i.e., 24,040 – 25,000)

$$\begin{aligned}
 r &= 7\% + (10\% - 7\%) \frac{1,019}{(1,019 + 960)} \\
 &= 7\% + (3\% \times 0.5) \\
 &= 7\% + 1.5\% \\
 &= 8.5\%
 \end{aligned}$$

## LEASES

The Department X will now use the interest rate of 8.5% to record the lease in its books and apportion the lease payments between the finance charge and the reduction of the lease liability, as shown in the table below.

### **Apportionment of Lease Payment (figures are rounded)**

	Year 0	Year 1	Year 2	Year 3	Year 4
Opening PV of Lease Liability	25,000	25,000	21,696	18,110	14,221
Interest Expense	-	2,125	1,844	1,539	1,209
Reduction of Liability	-	3,304	3,585	3,890	14,221*
Closing Lease Liability	25,000	21,696	18,110	14,221	-

\* Includes payment of guaranteed residual value.

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the proposed International Public Sector Accounting Standards. This Basis for Conclusions only notes the IPSASB's reasons for departing from the provisions of the related International Accounting Standard*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)'s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the 'comparison with IFRS' included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 13, issued in December 2001 was based on IAS 17 (Revised 1997), "Leases" which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 17 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The

<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

IASB's Bases for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)).

- BC6. IAS 17 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 12 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

### Comparison with IAS 17

IPSAS 13, “Leases” is drawn primarily from IAS 17, (revised 2003), “Leases.” The main differences between IPSAS 13 and IAS 17 are as follows:

- At the time of issuing this Standard, the IPSASB has not considered the applicability of IAS 41, “Agriculture,” to public sector entities, therefore IPSAS 13 does not reflect amendments made to IAS 17 consequent upon the issuing of IAS 41.
- Commentary additional to that in IAS 17 has been included in IPSAS 13 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 13 uses different terminology, in certain instances, from IAS 17. The most significant examples are the use of the terms statement of financial performance and statement of financial position in IPSAS 13. The equivalent terms in IAS 17 are income statement and balance sheet.
- IPSAS 13 does not use the term income, which in IAS 17 has a broader meaning than the term revenue.
- IAS 17 includes a definition of fair value in its set of definitions of technical terms, IPSAS 13 does not include this definition, as it is included in the “Glossary of Defined Terms” published separately (paragraph 7).

IPSAS 13 has additional implementation guidance which illustrates the classification of a lease, the treatment of a finance lease by a lessee, the treatment of a finance lease by a lessor, and the calculation of the interest rate implicit in a finance lease.

## **IPSAS 14—EVENTS AFTER THE REPORTING DATE**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 10 (revised 2003), “Events After the Balance Sheet Date” published by the International Accounting Standards Board (IASB). Extracts from IAS 10 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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International Public Sector Accounting Standard 14, “Events after the Reporting Date” (IPSAS 14) is set out in paragraphs 1–34. All the paragraphs have equal authority. IPSAS 14 should be read in the context of the Basis for Conclusion, and the “Preface to International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

IN1. International Public Sector Accounting Standard (IPSAS) 14, “Events after the Reporting Date,” replaces IPSAS 14, “Events after the Reporting Date” (issued December 2001), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## Reasons for Revising IPSAS 14

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 14 as a response to the International Accounting Standards Board’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 14, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 10, “Events after the Reporting Date” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 10 for a public sector specific reason; such variances are retained in this IPSAS 14 and are noted in the Comparison with IAS 10. Any changes to IAS 10 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 14.

## Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 14 are described below.

## Dividends or Similar Distributions Declared after the Reporting Date

IN5. The Standard clarifies in paragraph 16 that dividends or similar distributions declared after the reporting date are disclosed in the notes in accordance with IPSAS 1, “Presentation of Financial Statements.” Previously, IPSAS 14 stated that an entity could make the disclosure of such distributions after the reporting date either on the face of the statement of financial position as a separate component of net assets/equity or in the notes to the financial statements.

## Amendments to Other IPSASs

IN6. The Standard includes an authoritative appendix of amendments to other IPSASs that are not part of the IPSASs Improvements project and will be affected as a result of the proposals in this IPSAS

## IPSAS 14—EVENTS AFTER THE REPORTING DATE

### Objective

1. The objective of this Standard is to prescribe:
  - (a) When an entity should adjust its financial statements for events after the reporting date; and
  - (b) The disclosures that an entity should give about the date when the financial statements were authorized for issue and about events after the reporting date.

The Standard also requires that an entity should not prepare its financial statements on a going concern basis if events after the reporting date indicate that the going concern assumption is not appropriate.

### Scope

2. **An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in the accounting for, and disclosure of, events after the reporting date.**
3. **This Standard applies to all public sector entities other than Government Business Enterprises.**
4. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). GBEs are defined in paragraph 7 below.

### Definitions

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

**Events after the reporting date are those events, both favorable and unfavorable, that occur between the reporting date and the date when the financial statements are authorized for issue. Two types of events can be identified:**

- (a) **Those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and**
- (b) **Those that are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date).**

**Reporting date means the date of the last day of the reporting period to which the financial statements relate.**

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

### **Authorizing the Financial Statements for Issue**

6. In order to determine which events satisfy the definition of events after the reporting date, it is necessary to identify both the reporting date and the date on which the financial statements are authorized for issue. The reporting date is the last day of the reporting period to which the financial statements relate. The date of authorization for issue is the date on which the financial statements have received approval from the individual or body with the authority to finalize those statements for issue. The audit opinion is provided on those finalized financial statements. Events after the reporting date are all events, both favorable and unfavorable, that occur between the reporting date and the date when the financial statements are authorized for issue, even if those events occur after the publication of an announcement of the surplus or deficit, the authorization of the financial statements of a controlled entity, or publication of other selected information relating to the financial statements.
7. The process involved in preparing and authorizing the financial statements for issue may vary for different types of entities within and across jurisdictions. It can depend upon the nature of the entity, the governing body structure, the statutory requirements relating to that entity and the procedures followed in preparing and finalizing the financial statements. Responsibility for authorization of financial statements of individual government agencies may rest with the head of the central finance agency (or the senior finance official/accounting officer such as the controller or accountant-general). Responsibility for authorization of consolidated financial statements of the government as a whole may rest jointly with the head of the central finance agency (or the senior finance official such as the controller or accountant-general) and the finance minister (or equivalent).
8. In some cases, as the final step in the authorization process, an entity is required to submit its financial statements to another body (for example, a legislative body such as Parliament or a local council). This body may have the power to require changes to the audited financial statements. In other cases, the submission of statements to the other body may be merely a matter of protocol or process and that other body may not have the power to require changes to the statements. The date of authorization for issue of the financial statements will be determined in the context of the particular jurisdiction.

## Recognition and Measurement

9. In the period between the reporting date and the date of authorization for issue, elected government officials may announce a government's intentions in relation to certain matters. Whether or not these announced government intentions would require recognition as adjusting events would depend upon whether they provide more information about the conditions existing at reporting date and whether there is sufficient evidence that they can and will be fulfilled. In most cases, the announcement of government intentions will not lead to the recognition of adjusting events. Instead, they would generally qualify for disclosure as non-adjusting events.

## Adjusting Events After the Reporting Date

10. **An entity shall adjust the amounts recognized in its financial statements to reflect adjusting events after the reporting date.**
11. The following are examples of adjusting events after the reporting date that require an entity to adjust the amounts recognized in its financial statements, or to recognize items that were not previously recognized:
  - (a) The settlement after the reporting date of a court case that confirms that the entity had a present obligation at the reporting date. The entity adjusts any previously recognized provision related to this court case in accordance with IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets" or recognizes a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 24 in IPSAS 19.
  - (b) The receipt of information after the reporting date indicating that an asset was impaired at the reporting date, or that the amount of a previously recognized impairment loss for that asset needs to be adjusted. For example:
    - (i) the bankruptcy of a debtor which occurs after the reporting date usually confirms that a loss already existed at the reporting date on a receivable account and that the entity needs to adjust the carrying amount of the receivable account; and
    - (ii) the sale of inventories after the reporting date may give evidence about their net realizable value at the reporting date;
  - (c) The determination after the reporting date of the cost of assets purchased, or the proceeds from assets sold, before the reporting date;
  - (d) The determination after the reporting date of the amount of revenue collected during the reporting period to be shared with another

- government under a revenue sharing agreement in place during the reporting period;
- (e) The determination after the reporting date of performance bonus payments to be made to staff if the entity had a present legal or constructive obligation at the reporting date to make such payments as a result of events before that date; and
  - (f) The discovery of fraud or errors that show that the financial statements were incorrect.

#### **Non-adjusting Events After the Reporting Date**

- 12. **An entity shall not adjust the amounts recognized in its financial statements to reflect non-adjusting events after the reporting date.**
- 13. The following are examples of non-adjusting events after the reporting date:
  - (a) Where an entity has adopted a policy of regularly revaluing property to fair value, a decline in the fair value of property between the reporting date and the date when the financial statements are authorized for issue. The fall in fair value does not normally relate to the condition of the property at the reporting date, but reflects circumstances that have arisen in the following period. Therefore, despite its policy of regularly revaluing, an entity would not adjust the amounts recognized in its financial statements for the properties. Similarly, the entity does not update the amounts disclosed for the property as at the reporting date, although it may need to give additional disclosure under paragraph 29; and
  - (b) Where an entity charged with operating particular community service programs decides after the reporting date, but before the financial statements are authorized, to provide/distribute additional benefits directly or indirectly to participants in those programs. The entity would not adjust the expenses recognized in its financial statements in the current reporting period, although the additional benefits may meet the conditions for disclosure as non-adjusting events under paragraph 29.

#### **Dividends or Similar Distributions**

- 14. **If an entity declares dividends or similar distributions after the reporting date, the entity shall not recognize those distributions as a liability at the reporting date.**
- 15. Dividends may arise in the public sector when, for example, a public sector entity controls and consolidates the financial statements of a GBE that has outside ownership interests to whom it pays dividends. In addition, some public sector entities adopt a financial management framework, for example

“purchaser provider” models, that require them to pay income distributions to their controlling entity, such as the central government.

16. If dividends or similar distributions to owners are declared (i.e., the dividends or similar distributions are appropriately authorized and no longer at the discretion of the entity) after the reporting date but before the financial statements are authorized for issue, the dividends or similar distributions are not recognized as a liability at the reporting date because they do not meet the criteria of a present obligation in IPSAS 19. Such dividends or similar distributions are disclosed in the notes in accordance with IPSAS 1, “Presentation of Financial Statements. Dividends and similar distributions do not include a return of capital.

### Going Concern

17. The determination of whether the going concern assumption is appropriate needs to be considered by each entity. However, the assessment of going concern is likely to be of more relevance for individual entities than for a government as a whole. For example, an individual government agency may not be a going concern because the government of which it forms part has decided to transfer all its activities to another government agency. However, this restructuring has no impact upon the assessment of going concern for the government itself.
18. **An entity shall not prepare its financial statements on a going concern basis if those responsible for the preparation of the financial statements or the governing body determine after the reporting date either that there is an intention to liquidate the entity or to cease operating, or that there is no realistic alternative but to do so.**
19. In assessing whether the going concern assumption is appropriate for an individual entity, those responsible for the preparation of the financial statements, and/or the governing body, need to consider a wide range of factors. Those factors will include the current and expected performance of the entity, any announced and potential restructuring of organizational units, the likelihood of continued government funding and, if necessary, potential sources of replacement funding.
20. In the case of entities whose operations are substantially budget-funded, going concern issues generally only arise if the government announces its intention to cease funding the entity.
21. Some agencies, although not GBEs, may be required to be fully or substantially self-funding, and to recover the cost of goods and services from users. For any such entity, deterioration in operating results and financial position after the reporting date may indicate a need to consider whether the going concern assumption is still appropriate.

22. If the going concern assumption is no longer appropriate, this Standard requires an entity to reflect this in its financial statements. The impact of such a change will depend upon the particular circumstances of the entity, for example, whether operations are to be transferred to another government entity, sold or liquidated. Judgment is required in determining whether a change in the carrying value of assets and liabilities is required.
23. When the going concern assumption is no longer appropriate, it is also necessary to consider whether the change in circumstances leads to the creation of additional liabilities or triggers clauses in debt contracts leading to the reclassification of certain debts as current liabilities.
24. IPSAS 1 requires certain disclosures if:
  - (a) The financial statements are not prepared on a going concern basis. IPSAS 1 requires that when the financial statements are not prepared on a going concern basis, this must be disclosed, together with the basis on which the financial statements are prepared and the reason why the entity is not considered to be a going concern; or
  - (b) Those responsible for the preparation of the financial statements are aware of material uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern. The events or conditions requiring disclosure may arise after the reporting date. IPSAS 1 requires such uncertainties to be disclosed.

### **Restructuring**

25. Where a restructuring announced after the reporting date meets the definition of a non-adjustable event, the appropriate disclosures are made in accordance with this Standard. Guidance on the recognition of provisions associated with restructuring is found in IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets." Simply because a restructuring involves the disposal of a component of an entity this does not in itself bring into question the entity's ability to continue as a going concern. However, where a restructuring announced after the reporting date means that an entity is no longer a going concern, the nature and amount of assets and liabilities recognized may change.

### **Disclosure**

#### **Disclosure of Date of Authorization for Issue**

26. **An entity shall disclose the date when the financial statements were authorized for issue and who gave that authorization. If another body has the power to amend the financial statements after issuance, the entity shall disclose that fact.**

27. It is important for users to know when the financial statements were authorized for issue, as the financial statements do not reflect events after this date. It is also important for users to know of the rare circumstances in which any persons or organizations have the authority to amend the financial statements after issuance. Examples of individuals or bodies that may have the power to amend the financial statements after issuance are Ministers, the government of which the entity forms part, Parliament or an elected body of representatives. If changes are made, the amended financial statements are a new set of financial statements.

#### **Updating Disclosure about Conditions at the Reporting Date**

28. **If an entity receives information after the reporting date, but before the financial statements are authorized for issue, about conditions that existed at the reporting date, the entity shall update disclosures that relate to these conditions, in the light of the new information.**
29. In some cases, an entity needs to update the disclosures in its financial statements to reflect information received after the reporting date but before the financial statements are authorized for issue, even when the information does not affect the amounts that the entity recognizes in its financial statements. One example of the need to update disclosures is when evidence becomes available after the reporting date about a contingent liability that existed at the reporting date. In addition to considering whether it should now recognize a provision an entity updates its disclosures about the contingent liability in the light of that evidence.

#### **Disclosure of Non-adjusting Events After the Reporting Date**

30. **If non-adjusting events after the reporting date are material non-disclosure could influence the economic decisions of users taken on the basis of the financial statements. Accordingly, an entity shall disclose the following for each material category of non-adjusting event after the reporting date:**
- (a) **The nature of the event; and**
  - (b) **An estimate of its financial effect, or a statement that such an estimate cannot be made.**
31. The following are examples of non-adjusting events after the reporting date that would generally result in disclosure:
- (a) An unusually large decline in the value of property carried at fair value, where that decline is unrelated to the condition of the property at reporting date, but is due to circumstances that have arisen since reporting date;

- (b) The entity decides after reporting date, to provide/distribute substantial additional benefits in the future directly or indirectly to participants in community service programs that it operates, and those additional benefits have a major impact on the entity;
- (c) An acquisition or disposal of a major controlled entity or the outsourcing of all or substantially all of the activities currently undertaken by an entity after the reporting date;
- (d) Announcing a plan to discontinue an operation or major program, disposing of assets or settling liabilities attributable to a discontinued operation or major program, or entering into binding agreements to sell such assets or settle such liabilities (guidance on the treatment and disclosure of discontinued operations can be found in the relevant international or national accounting standard dealing with discontinued operations);
- (e) Major purchases and disposals of assets;
- (f) The destruction of a major building by a fire after the reporting date;
- (g) Announcing, or commencing the implementation of, a major restructuring (guidance on accounting for provisions associated with restructuring is found in accounting standards on provisions, contingent liabilities and contingent assets);
- (h) The introduction of legislation to forgive loans made to entities or individuals as part of a program;
- (i) Abnormally large changes after the reporting date in asset prices or foreign exchange rates;
- (j) In the case of entities that are liable for income tax or income tax equivalents, changes in tax rates or tax laws enacted or announced after the reporting date that have a significant effect on current and deferred tax assets and liabilities (guidance on accounting for income taxes can be found in the relevant international or national accounting standard dealing with income taxes);
- (k) Entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees after the reporting date; and
- (l) Commencing major litigation arising solely out of events that occurred after the reporting date.

### Effective Date

32. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on**

**or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**

33. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

#### **Withdrawal of IPSAS 14 (2001)**

34. This Standard supersedes IPSAS 12, "Inventories" issued in 2001.

## Appendix

### Amendments to Other IPSASs

*The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after January 1, 2008. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.*

A1. In IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets” paragraph 87 is amended to read as follows:

87. A decision by management or the governing body to restructure taken before the reporting date does not give rise to a constructive obligation at the reporting date unless the entity has, before the reporting date:

- (a) Started to implement the restructuring plan; or
- (b) Announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting date, disclosure is required under International Public Sector Accounting Standard IPSAS 14, “Events After the Reporting Date,” if the restructuring is material and non-disclosure could influence the economic decision of users taken on the financial statements.

A2. In International Public Sector Accounting Standards applicable at MM YYYY, references to the current version of IPSAS 14, “Events After the Reporting Date” are amended to IPSAS 14, “Events after the Reporting Date.”

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the proposed International Public Sector Accounting Standards. This Basis for Conclusions only notes the IPSASB's reasons for departing from the provisions of the related International Accounting Standard.*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)'s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the 'comparison with IFRS' included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 14, issued in December 2001 was based on IAS 10 (Revised 1999), "Events After the Balance Sheet Date" which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 10 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made.

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<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

(The IASB's Bases for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)).

- BC6. IAS 10 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 12 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

### **Comparison with IAS 10**

IPSAS 14, “Events After the Reporting Date” is drawn primarily from IAS 10 (revised 2003), “Events After the Balance Sheet Date.” The main differences between IPSAS 14 and IAS 10 are as follows:

- IPSAS 14 notes that where the going concern assumption is no longer appropriate, judgment is required in determining the impact of this change on the carrying value of assets and liabilities recognized in the financial statements (paragraph 22).
- IPSAS 14 contains additional commentary on determining the date of authorization for issue (paragraphs 6, 7 and 8).
- Commentary additional to that in IAS 10 has been included in IPSAS 14 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 14 uses different terminology, in certain instances, from IAS 10. The most significant examples are the use of the terms statement of financial position, net assets/equity and reporting date in IPSAS 14. The equivalent terms in IAS 10 are balance sheet, equity and balance sheet date.
- IPSAS 14 does not use the term income, which in IAS 10 has a broader meaning than the term revenue.
- IPSAS 14 contains a definition of reporting date, IAS 10 does not contain a definition of balance sheet date.

## **IPSAS 15—FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 32 (revised 1998), “Financial Instruments: Disclosure and Presentation” published by the International Accounting Standards Board (IASB). Extracts from IAS 32 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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**IPSAS 15—FINANCIAL INSTRUMENTS:  
DISCLOSURE AND PRESENTATION**

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*The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.*

Some public sector entities such as national governments and public sector financial institutions may hold a wide range of financial instruments. However, some individual government agencies may not issue or hold a wide range of instruments. In such cases, the Standard will have limited application and preparers of financial statements will need to identify those aspects of the Standard that apply to them. The purpose of the implementation guide located in Appendix 1 is to assist preparers in this task.

## **Objective**

The dynamic nature of international financial markets has resulted in the widespread use of a variety of financial instruments ranging from traditional primary instruments, such as bonds, to various forms of derivative instruments, such as interest rate swaps. Public sector entities use a wide range of financial instruments from simple instruments such as payables and receivables to more complex instruments (such as cross-currency swaps to hedge commitments in foreign currencies) in their operations. To a lesser extent, public sector entities may issue equity instruments or compound liability/equity instruments. This may occur where an economic entity includes a partly-privatized Government Business Enterprise (GBE) that issues equity instruments into the financial markets or where a public sector entity issues debt instruments that convert to an ownership interest under certain conditions.

The objective of this Standard is to enhance financial statement users’ understanding of the significance of on-balance-sheet and off-balance-sheet financial instruments to a government’s or other public sector entity’s financial position, performance and cash flows. In this Standard, references to balance sheet in the context of on-balance-sheet and off-balance-sheet have the same meaning as statement of financial position.

The Standard prescribes certain requirements for presentation of on-balance-sheet financial instruments and identifies the information that should be disclosed about both on-balance-sheet (recognized) and off-balance-sheet (unrecognized) financial instruments. The presentation standards deal with the classification of financial instruments between liabilities and net assets/equity, the classification of related interest, dividends, revenues and expenses, and the circumstances in which financial assets and financial liabilities should be offset. The disclosure standards deal with information about factors that affect the amount, timing and certainty of an entity’s future cash flows relating to financial instruments and the accounting policies applied to the instruments. In addition, the Standard encourages disclosure of information about the nature and extent of an entity’s use of financial instruments, the financial purposes that they serve, the risks associated with them and management’s policies for controlling those risks.

## Scope

1. **An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard for the presentation and disclosure of financial instruments.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”
4. **This Standard should be applied in presenting and disclosing information about all types of financial instruments, both recognized and unrecognized, other than:**
  - (a) **Interests in controlled entities, as defined in International Public Sector Accounting Standard (IPSAS) 6, “Consolidated and Separate Financial Statements”;**
  - (b) **Interests in associates, as defined in IPSAS 7, “Accounting for Investments in Associates”;**
  - (c) **Interests in joint ventures, as defined in IPSAS 8, “Interests in Joint Ventures”;**
  - (d) **Obligations arising under insurance contracts;**
  - (e) **Employers’ and plans’ obligations for post-employment benefits of all types, including employee benefit plans; and**
  - (f) **Obligations for payments arising under social benefits provided by an entity for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those benefits. However, entities shall apply this Standard to an interest in a controlling entity, associate or joint venture that according to IPSAS 6, IPSAS 7 or IPSAS 8 is accounted for as a financial instrument. In these cases, entities shall apply the disclosure requirements in IPSAS 6, IPSAS 7 and IPSAS 8 in addition to those in this Standard.**
5. This Standard does not apply to an entity’s net assets/equity interests in controlled entities. However, it does apply to all financial instruments included in the consolidated financial statements of a controlling entity, regardless of whether those instruments are held or issued by the controlling

entity or by a controlled entity. Similarly, the Standard applies to financial instruments held or issued by a joint venture and included in the financial statements of a venturer either directly or through proportionate consolidation.

6. Some economic entities in the public sector may include entities that issue insurance contracts. Those entities are within the scope of this Standard. However, this Standard excludes the insurance contracts themselves from its scope. For the purposes of this Standard, an insurance contract is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and interruption of operations. However, the provisions of this Standard apply when a financial instrument takes the form of an insurance contract but principally involves the transfer of financial risks (see paragraph 49), for example, some types of financial reinsurance and guaranteed investment contracts issued by public sector insurance and other entities. Entities that have obligations under insurance contracts are encouraged to consider the appropriateness of applying the provisions of this Standard in presenting and disclosing information about such obligations.
7. This Standard does not apply to financial instruments that arise from obligations from employee benefit schemes or obligations of a government to provide social benefits to its citizens for which it receives no consideration, or consideration that is not approximately equal to the fair value of the benefits, directly in return from the recipients of those benefits (such as old age pensions, unemployment benefits, disability benefits and other forms of financial assistance provided by governments).
8. Additional guidance on the presentation and disclosure of specific types of financial instruments can be found in international and/or national accounting standards. For example, IPSAS 13, "Leases" contains specific disclosure requirements relating to finance leases.

## Definitions

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

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

**Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.**

**Financial asset is any asset that is:**

- (a) **Cash;**

- (b) A contractual right to receive cash or another financial asset from another entity;
- (c) A contractual right to exchange financial instruments with another entity under conditions that are potentially favorable; or
- (d) An equity instrument of another entity.

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

Commodity-based contracts that give either party the right to settle in cash or some other financial instrument should be accounted for as if they were financial instruments, with the exception of commodity contracts that (a) were entered into and continue to meet the entity's expected purchase, sale, or usage requirements, (b) were designated for that purpose at their inception, and (c) are expected to be settled by delivery.

**Financial liability** is any liability that is a contractual obligation:

- (a) To deliver cash or another financial asset to another entity; or
- (b) To exchange financial instruments with another entity under conditions that are potentially unfavorable.

An entity may have a contractual obligation that it can settle either by payment of financial assets or by payment in the form of its own equity securities. In such a case, if the number of equity securities required to settle the obligation varies with changes in their fair value so that the total fair value of the equity securities paid always equals the amount of the contractual obligation, the holder of the obligation is not exposed to gain or loss from fluctuations in the price of its equity securities. Such an obligation should be accounted for as a financial liability of the entity.

**An insurance contract** (for the purposes of this Standard) is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and interruption of operations.

**Market value** is the amount obtainable from the sale, or payable on the acquisition, of a financial instrument in an active market.

Monetary financial assets and financial liabilities (also referred to as monetary financial instruments) are financial assets and financial liabilities to be received or paid in fixed or determinable amounts of money.

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

10. In this Standard, the terms contract and contractual refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable at law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.
11. For purposes of the definitions in paragraph 9, the term entity includes public sector bodies, individuals, partnerships and incorporated bodies.
12. Parts of the definitions of a financial asset and a financial liability include the terms financial asset and financial instrument, but the definitions are not circular. When there is a contractual right or obligation to exchange financial instruments, the instruments to be exchanged give rise to financial assets, financial liabilities, or equity instruments. A chain of contractual rights or obligations may be established but it ultimately leads to the receipt or payment of cash or to the acquisition or issuance of an equity instrument.
13. Financial instruments include both primary instruments, such as receivables, payables and equity securities, and derivative instruments, such as financial options, futures and forwards, interest rate swaps and currency swaps. Derivative financial instruments, whether recognized or unrecognized, meet the definition of a financial instrument and, accordingly, are subject to this Standard.
14. Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. Derivative instruments do not result in a transfer of the underlying primary financial instrument on inception of the contract and such a transfer does not necessarily take place on maturity of the contract.
15. Physical assets such as inventories, property, plant and equipment, leased assets and intangible assets such as radio spectrum, patents and trademarks are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or other assets but it does not give rise to a present right to receive cash or other financial assets.
16. Assets, such as prepaid expenses, for which the future economic benefit is the receipt of goods or services rather than the right to receive cash or another financial asset are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the probable outflow of economic benefits associated with them is the delivery of goods and services rather than cash or another financial asset.

17. Liabilities or assets that are not contractual in nature, such as income taxes or tax equivalents that are created as a result of statutory requirements imposed on public sector entities by governments, are not financial liabilities or financial assets. International Accounting Standard (IAS) 12, “Income Taxes” provides guidance on accounting for income taxes.
18. Contractual rights and obligations that do not involve the transfer of a financial asset do not fall within the scope of the definition of a financial instrument. For example, some contractual rights (obligations), such as those that arise under a commodity futures contract, can be settled only by the receipt (delivery) of non-financial assets. Similarly, contractual rights (obligations) such as those that arise under an operating lease or build-own-operate arrangement for use of a physical asset, such as a hospital, can be settled only by the receipt (delivery) of services. In both cases, the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. (Refer to Appendix 2, paragraphs A13–A17.)
19. The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender’s ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though many such assets and liabilities do not qualify for recognition in financial statements. For example, a national government may provide a private sector operator of an infrastructure facility protection against demand risk by guaranteeing a minimum level of revenue. The guarantee is a contingent obligation of the government until it becomes probable that the operator’s revenue will fall below the guaranteed minimum.
20. An obligation of an entity to issue or deliver its own equity instruments, such as a share option or warrant, is itself an equity instrument, not a financial liability, since the entity is not obliged to deliver cash or another financial asset. Similarly, the cost incurred by an entity to purchase a right to re-acquire its own equity instruments from another party is a deduction from its net assets/equity, not a financial asset.
21. The minority interest that may arise on an entity’s statement of financial position from consolidating a controlled entity is not a financial liability or an equity instrument of the entity. In consolidated financial statements, an

entity presents the interests of other parties in the net assets/equity and the net surplus or deficit of its controlled entities in accordance with IPSAS 6. Accordingly, a financial instrument classified as an equity instrument by a controlled entity is eliminated on consolidation when held by the controlling entity, or presented by the controlling entity in the consolidated statement of financial position as a minority interest separate from the net assets/equity of its own shareholders. A financial instrument classified as a financial liability by a controlled entity remains a liability in the controlling entity's consolidated statement of financial position unless eliminated on consolidation as an intra-economic entity balance. The accounting treatment by the controlling entity on consolidation does not affect the basis of presentation by the controlled entity in its financial statements.

## Presentation

### Liabilities and Net assets/Equity

22. **The issuer of a financial instrument should classify the instrument, or its component parts, as a liability or as net assets/equity in accordance with the substance of the contractual arrangement on initial recognition and the definitions of a financial liability and an equity instrument.**
23. The substance of a financial instrument, rather than its legal form, governs its classification on the issuer's statement of financial position. While substance and legal form are commonly consistent, this is not always the case. For example, some financial instruments take the legal form of equity but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. The classification of an instrument is made on the basis of an assessment of its substance when it is first recognized. That classification continues at each subsequent reporting date until the financial instrument is removed from the entity's statement of financial position. The classification of financial instruments as either liabilities or net assets/equity are not likely to be a significant issue for many reporting entities in the public sector.
24. Classification of financial instruments between liabilities and net assets/equity is required because of the different risks associated with each. Entities with instruments classified as financial liabilities are required to disclose information on interest rate risk exposure in accordance with paragraph 63, and to recognize interest, dividends, losses or gains as revenue or expense in accordance with paragraph 36. Paragraph 36 also specifies that distributions to holders of financial instruments classified as equity instruments should be debited by the issuer directly to net assets/equity.
25. While public sector entities will often hold an equity instrument as an investment (financial assets) it is not common for a public sector entity to

issue equity instruments to parties outside the economic entity except where a controlled entity is partly-privatized. Nevertheless, the use of financial instruments in the public sector continues to evolve and classification by the issuer needs to be guided by their substance and not necessarily their form.

26. The critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation on one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange another financial instrument with the holder under conditions that are potentially unfavorable to the issuer. When such a contractual obligation exists, that instrument meets the definition of a financial liability regardless of the manner in which the contractual obligation will be settled. A restriction on the ability of the issuer to satisfy an obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the issuer's obligation or the holder's right under the instrument.
27. When a financial instrument does not give rise to a contractual obligation on the part of the issuer to deliver cash or another financial asset or to exchange another financial instrument under conditions that are potentially unfavorable, it is an equity instrument. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or other distributions out of net assets/equity, the issuer does not have a contractual obligation to make such distributions.
28. A public sector entity may issue instruments with particular rights, such as preferred shares. When a preferred share provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date or gives the holder the right to require the issuer to redeem the share at or after a particular date for a fixed or determinable amount, the instrument meets the definition of a financial liability and is classified as such. A preferred share that does not establish such a contractual obligation explicitly may establish it indirectly through its terms and conditions. For example, a preferred share that does not provide for mandatory redemption or redemption at the option of the holder may have a contractually provided accelerating dividend such that, within the foreseeable future, the dividend yield is scheduled to be so high that the issuer will be economically compelled to redeem the instrument. In these circumstances, classification as a financial liability is appropriate because the issuer has little, if any, discretion to avoid redeeming the instrument. Similarly, if a financial instrument labeled as a share gives the holder an option to require redemption upon the occurrence of a future event that is highly likely to occur, classification as a financial liability on initial recognition reflects the substance of the instrument. (Refer to Appendix 2, paragraphs A7–A8 and A18–A21.)

**Classification of Compound Instruments by the Issuer**

29. **The issuer of a financial instrument that contains both a liability and a net assets/equity element should classify the instrument's component parts separately in accordance with paragraph 22.**
30. Public sector entities do not commonly issue compound financial instruments. The exceptions include partly-privatized GBEs within an economic entity that issues compound instruments into the financial markets. Where a public sector entity issues a compound instrument, this Standard requires the separate presentation on an issuer's statement of financial position of liability and net assets/equity elements created by a single financial instrument. It is more a matter of form than substance that both liabilities and net assets/equity interests are created by a single financial instrument rather than two or more separate instruments. An issuer's financial position is more faithfully represented by separate presentation of liability and net assets/equity components contained in a single instrument according to their nature. (Refer to Appendix 2, paragraphs A22–A23.)
31. For purposes of statement of financial position presentation, an issuer recognizes separately the component parts of a financial instrument that creates a primary financial liability of the issuer and grants an option to the holder of the instrument to convert it into an equity instrument of the issuer. A bond or similar instrument convertible by the holder into common shares of the issuer is an example of such an instrument. From the perspective of the issuer, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or other financial assets) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert into common shares of the issuer). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase common shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the issuer presents the liability and net assets/equity elements separately on its statement of financial position.
32. Classification of the liability and net assets/equity components of a convertible instrument is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the manner that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The issuer's obligation to make future payments remains outstanding until it is extinguished through conversion, the maturity of the instrument or some other transaction.

33. A financial instrument may contain components that are neither financial liabilities nor equity instruments of the issuer. For example, an instrument may give the holder the right to receive a non-financial asset such as a right to operate a government owned monopoly or a commodity in settlement and an option to exchange that right for shares of the issuer. The issuer recognizes and presents the equity instrument (the exchange option) separately from the liability components of the compound instrument, whether the liabilities are financial or non-financial.
34. This Standard does not deal with measurement of financial assets, financial liabilities and equity instruments and does not therefore prescribe any particular method for assigning a carrying amount to liability and net assets/equity elements contained in a single instrument. Approaches that might be followed include:
- (a) Assigning to the less easily measurable component (often an equity instrument), the residual amount after deducting from the instrument as a whole the amount separately determined for the component that is more easily measurable; and
  - (b) Measuring the liability and net assets/equity components separately and, to the extent necessary, adjusting these amounts on a pro rata basis so that the sum of the components equals the amount of the instrument as a whole.

The sum of the carrying amounts assigned to the liability and net assets/equity components on initial recognition is always equal to the carrying amount that would be ascribed to the instrument as a whole. No gain or loss arises from recognizing and presenting the components of the instrument separately.

35. Under the first approach described in paragraph 34, where, for example, a public sector entity issues a bond convertible into an equity interest it first determines the carrying amount of the financial liability by discounting the stream of future payments of interest and principal at the prevailing market rate for a similar liability that does not have an associated net assets/equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into common shares may then be determined by deducting the carrying amount of the financial liability from the amount of the compound instrument as a whole. Under the second approach, the issuer determines the value of the option directly either by reference to the fair value of a similar option, if one exists, or by using an option pricing model. The value determined for each component is then adjusted on a pro-rata basis to the extent necessary to ensure that the sum of the carrying amounts assigned to the components equals the amount of the consideration received for the convertible bond. (Refer to Appendix 2, paragraph A24.)

**Interest, Dividends, Losses and Gains**

36. **Interest, dividends, losses and gains relating to a financial instrument, or a component part, classified as a financial liability should be reported in the statement of financial performance as expense or revenue. Distributions to holders of a financial instrument classified as an equity instrument should be debited by the issuer directly to net assets/equity.**
37. The classification of a financial instrument in the statement of financial position determines whether interest, dividends, losses and gains relating to that instrument are classified as expenses or revenue and reported in the statement of financial performance. Thus, dividend payments on shares classified as liabilities are classified as expenses in the same way as interest on a bond and reported in the statement of financial performance. Similarly, gains and losses associated with redemptions or refinancings of instruments classified as liabilities are reported in the statement of financial performance, while redemptions or refinancings of instruments classified as net assets/equity of the issuer are reported as movements in net assets/equity.
38. Dividends classified as an expense may be presented in the statement of financial performance either with interest on other liabilities or as a separate item. Disclosure of interest and dividends is subject to the requirements of IPSAS 1, "Presentation of Financial Statements." In some circumstances, because of significant differences between interest and dividends with respect to matters such as tax deductibility, it is desirable to disclose them separately within the statement of financial performance. For entities subject to income taxes, guidance on the disclosure of the amounts of tax effects can be found in IAS 12.

**Offsetting of a Financial Asset and a Financial Liability**

39. **A financial asset and a financial liability should be offset and the net amount reported in the statement of financial position when an entity:**
- (a) **Has a legally enforceable right to set off the recognized amounts; and**
  - (b) **Intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.**
40. This Standard requires the presentation of financial assets and financial liabilities on a net basis when this reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. For example, a state government settles a financial liability to a national government on a net basis (that is, after deducting a financial asset it was

owed by the national government). In other circumstances, financial assets and financial liabilities are presented separately from each other consistent with their characteristics as assets or liabilities of the entity. (Refer to Appendix 2, paragraph A25.)

41. Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from ceasing to recognize a financial asset or a financial liability. While offsetting does not give rise to recognition of a gain or a loss, ceasing to recognize a financial instrument not only results in the removal of the previously recognized item from the statement of financial position but may also result in recognition of a gain or a loss.
42. A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement among the three parties that clearly establishes the debtor's right of set-off. Since the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and care must be taken to establish which laws apply to the relationships between the parties.
43. The existence of an enforceable right to set off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect significantly an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows are not affected. When an entity does intend to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting since the rights and obligations associated with the individual financial asset and financial liability remain unaltered.
44. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off but does not intend to settle net or to realize the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with the standard in paragraph 73.
45. Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organized financial

market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realization of a financial asset and settlement of a financial liability are considered simultaneous only when the transactions occur at the same moment.

46. The conditions set out in paragraph 39 are generally not satisfied and offsetting is usually inappropriate when:
- (a) Several different financial instruments are used to emulate the features of a single financial instrument (that is, a synthetic instrument);
  - (b) Financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (for example, assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;
  - (c) Financial or other assets are pledged as collateral for non-recourse financial liabilities;
  - (d) Financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (for example, a sinking fund arrangement); or
  - (e) Obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance policy.
47. An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a “master netting arrangement” with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements are commonly used by financial institutions to provide protection against loss in the event of bankruptcy or other events that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realization or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of operations. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 39 are satisfied. When financial assets and financial

liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity's exposure to credit risk is disclosed in accordance with paragraph 73.

## Disclosure

48. The purpose of the disclosures required by this Standard is to provide information that will enhance understanding of the significance of on-balance-sheet and off-balance-sheet financial instruments to an entity's financial position, performance and cash flows and assist in assessing the amounts, timing and certainty of future cash flows associated with those instruments. In addition to providing specific information about particular financial instrument balances and transactions, entities are encouraged to provide a discussion of the extent to which financial instruments are used, the associated risks and the financial purposes served. A discussion of management's policies for controlling the risks associated with financial instruments, including policies on matters such as hedging of risk exposures, avoidance of undue concentrations of risk and requirements for collateral to mitigate credit risks, provides a valuable additional perspective that is independent of the specific instruments outstanding at a particular time. Some entities provide such information in a commentary that accompanies their financial statements rather than as part of the financial statements.
49. Transactions in financial instruments may result in an entity assuming or transferring to another party one or more of the financial risks described below. The required disclosures provide information that assists users of financial statements in assessing the extent of risk related to both recognized and unrecognized financial instruments.
- (a) Price risk—There are three types of price risk: currency risk, interest rate risk and market risk.
- (i) Currency risk is the risk that the value of a financial instrument will fluctuate due to changes in foreign exchange rates.
- (ii) Interest rate risk is the risk that the value of a financial instrument will fluctuate due to changes in market interest rates.
- (iii) Market risk is the risk that the value of a financial instrument will fluctuate as a result of changes in market prices whether those changes are caused by factors specific to the individual security or its issuer or factors affecting all securities traded in the market.

The term price risk embodies not only the potential for loss but also the potential for gain.

- (b) Credit risk—Credit risk is the risk that one party to a financial instrument will fail to discharge an obligation and cause the other party to incur a financial loss.
- (c) Liquidity risk—Liquidity risk, also referred to as funding risk, is the risk that an entity will encounter difficulty in raising funds to meet commitments associated with financial instruments. Liquidity risk may result from an inability to sell a financial asset quickly at close to its fair value. For some public sector entities, such as a national government, liquidity risks may be mitigated by raising taxes or other charges levied by the entity.
- (d) Cash flow risk—Cash flow risk is the risk that future cash flows associated with a monetary financial instrument will fluctuate in amount. In the case of a floating rate debt instrument, for example, such fluctuations result in a change in the effective interest rate of the financial instrument, usually without a corresponding change in its fair value.

#### Disclosure of Risk Management Policies

- 50. **An entity should describe its financial risk management objectives and policies, including its policy for hedging each major type of forecasted transaction for which hedge accounting is used.**
- 51. The standards do not prescribe either the format of the information required to be disclosed or its location within the financial statements. With regard to recognized financial instruments, to the extent that the required information is presented on the face of the statement of financial position, it is not necessary for it to be repeated in the notes to the financial statements. With regard to unrecognized financial instruments, however, information in notes or supplementary schedules is the primary means of disclosure. Disclosures may include a combination of narrative descriptions and specific quantified data, as appropriate to the nature of the instruments and their relative significance to the entity.
- 52. Determination of the level of detail to be disclosed about particular financial instruments is a matter for the exercise of judgment taking into account the relative significance of those instruments. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring significant information as a result of too much aggregation. For example, when an entity is party to large numbers of financial instruments with similar characteristics and no one contract is individually significant, summarized information by reference to particular classes of instruments is appropriate. On the other hand, specific information about an individual instrument may

be important when that instrument represents, for example, a significant element in an entity's capital structure.

53. Management of an entity group's financial instruments into classes that are appropriate to the nature of the information to be disclosed, taking into account matters such as the characteristics of the instruments, whether they are recognized or unrecognized and, if they are recognized, the measurement basis that has been applied. In general, classes are determined on a basis that distinguishes items carried on a cost basis from items carried at fair value. When amounts disclosed in notes or supplementary schedules relate to recognized assets and liabilities, sufficient information is provided to permit a reconciliation to relevant line items on the statement of financial position. When an entity is a party to financial instruments not dealt with by this Standard, such as obligations under retirement benefit plans or insurance contracts, these instruments constitute a class or classes of financial assets or financial liabilities disclosed separately from those dealt with by this Standard.

#### **Terms, Conditions and Accounting Policies**

54. **For each class of financial asset, financial liability and equity instrument, both recognized and unrecognized, an entity should disclose:**
- (a) **Information about the extent and nature of the financial instruments, including significant terms and conditions that may affect the amount, timing and certainty of future cash flows; and**
  - (b) **The accounting policies and methods adopted, including the criteria for recognition and the basis of measurement applied.**
55. The contractual terms and conditions of a financial instrument are an important factor affecting the amount, timing and certainty of future cash receipts and payments by the parties to the instrument. When recognized and unrecognized instruments are important, either individually or as a class, in relation to the current financial position of an entity or its future operating results, their terms and conditions are disclosed. If no single instrument is individually significant to the future cash flows of a particular entity, the essential characteristics of the instruments are described by reference to appropriate groupings of like instruments.
56. When financial instruments held or issued by an entity, either individually or as a class, create a potentially significant exposure to the risks described in paragraph 49, terms and conditions that may warrant disclosure include:
- (a) The principal, stated, face or other similar amount which, for some derivative instruments, such as interest rate swaps, may be the

- amount (referred to as the notional amount) on which future payments are based;
- (b) The date of maturity, expiry or execution;
  - (c) Early settlement options held by either party to the instrument, including the period in which, or date at which, the options may be exercised and the exercise price or range of prices;
  - (d) Options held by either party to the instrument to convert the instrument into, or exchange it for, another financial instrument or some other asset or liability, including the period in which, or date at which, the options may be exercised and the conversion or exchange ratio(s);
  - (e) The amount and timing of scheduled future cash receipts or payments of the principal amount of the instrument, including installment repayments and any sinking fund or similar requirements;
  - (f) Stated rate or amount of interest, dividend or other periodic return on principal and the timing of payments;
  - (g) Collateral held, in the case of a financial asset, or pledged, in the case of a financial liability;
  - (h) In the case of an instrument for which cash flows are denominated in a currency other than the entity's reporting currency, the currency in which receipts or payments are required;
  - (i) In the case of an instrument that provides for an exchange, information described in items (a) to (h) for the instrument to be acquired in the exchange; and
  - (j) Any condition of the instrument or an associated covenant that, if contravened, would significantly alter any of the other terms (for example, a maximum debt-to-net assets/equity ratio in a bond covenant that, if contravened, would make the full principal amount of the bond due and payable immediately).
57. When the statement of financial position presentation of a financial instrument differs from the instrument's legal form, it is desirable for an entity to explain in the notes to the financial statements the nature of the instrument.
58. The usefulness of information about the extent and nature of financial instruments is enhanced when it highlights any relationships between individual instruments that may affect the amount, timing or certainty of the future cash flows of an entity. For example, it is important to disclose hedging relationships such as might exist when a central borrowing authority holds an investment in shares for which it has purchased a put option. Similarly, it is important to disclose relationships between the

components of “synthetic instruments” such as fixed rate debt created by borrowing at a floating rate and entering into a floating to fixed interest rate swap. In each case, an entity presents the individual financial assets and financial liabilities in its statement of financial position according to their nature, either separately or in the class of financial asset or financial liability to which they belong. The extent to which a risk exposure is altered by the relationships among the assets and liabilities may be apparent to financial statement users from information of the type described in paragraph 56 but in some circumstances further disclosure is necessary.

59. In accordance with IPSAS 1, an entity provides clear and concise disclosure of all significant accounting policies, including both the general principles adopted and the method of applying those principles to significant transactions and circumstances arising in the entity’s operations. In the case of financial instruments, such disclosure includes:
- (a) The criteria applied in determining when to recognize a financial asset or financial liability on the statement of financial position and when to cease to recognize it;
  - (b) The basis of measurement applied to financial assets and financial liabilities both on initial recognition and subsequently; and
  - (c) The basis on which revenue and expense arising from financial assets and financial liabilities is recognized and measured.
60. Types of transactions for which it may be necessary to disclose the relevant accounting policies include:
- (a) Transfers of financial assets when there is a continuing interest in, or involvement with, the assets by the transferor, such as securitizations of financial assets, repurchase agreements and reverse repurchase agreements;
  - (b) Transfers of financial assets to a trust for the purpose of satisfying liabilities when they mature without the obligation of the transferor being discharged at the time of the transfer, such as an in-substance defeasance trust;
  - (c) Acquisition or issuance of separate financial instruments as part of a series of transactions designed to synthesize the effect of acquiring or issuing a single instrument;
  - (d) Acquisition or issuance of financial instruments as hedges of risk exposures, such as an interest rate swap to hedge a finance lease obligation; and
  - (e) Acquisition or issuance of monetary financial instruments bearing a stated interest rate that differs from the prevailing market rate at the

date of issue, such as the issue of bonds by a central borrowing authority at a discount. (Refer to Appendix 2, paragraph A26)

61. To provide adequate information for users of financial statements to understand the basis on which financial assets and financial liabilities have been measured, disclosures of accounting policies indicate not only whether cost, fair value or some other basis of measurement has been applied to a specific class of asset or liability but also the method of applying that basis. For example, for financial instruments carried on the cost basis, an entity may be required to disclose how it accounts for:
- (a) Costs of acquisition or issuance;
  - (b) Premiums and discounts on monetary financial assets and financial liabilities;
  - (c) Changes in the estimated amount of determinable future cash flows associated with a monetary financial instrument such as a bond indexed to a commodity price;
  - (d) Changes in circumstances that result in significant uncertainty about the timely collection of all contractual amounts due from monetary financial assets;
  - (e) Declines in the fair value of financial assets below their carrying amount; and
  - (f) Restructured financial liabilities.

For financial assets and financial liabilities carried at fair value, an entity indicates whether carrying amounts are determined from quoted market prices, independent appraisals, discounted cash flow analysis or another appropriate method, and discloses any significant assumptions made in applying those methods. (Refer to Appendix 2, paragraph A27.)

62. An entity discloses the basis for reporting in the statement of financial performance realized and unrealized gains and losses, interest and other items of revenue and expense associated with financial assets and financial liabilities. This disclosure includes information about the basis on which revenue and expense arising from financial instruments held for hedging purposes are recognized. When an entity presents revenue and expense items on a net basis even though the corresponding financial assets and financial liabilities on the statement of financial position have not been offset, the reason for that presentation is disclosed if the effect is significant.

### **Interest Rate Risk**

63. **For each class of financial asset and financial liability, both recognized and unrecognized, an entity should disclose information about its exposure to interest rate risk, including:**

- (a) **Contractual repricing or maturity dates, whichever dates are earlier; and**
  - (b) **Effective interest rates, when applicable.**
64. An entity provides information concerning its exposure to the effects of future changes in the prevailing level of interest rates. Changes in market interest rates have a direct effect on the contractually determined cash flows associated with some financial assets and financial liabilities (cash flow risk) and on the fair value of others (price risk).
65. Information about maturity dates, or repricing dates when they are earlier, indicates the length of time for which interest rates are fixed and information about effective interest rates indicates the levels at which they are fixed. Disclosure of this information provides financial statement users with a basis for evaluating the interest rate price risk to which an entity is exposed and thus the potential for gain or loss. For instruments that reprice to a market rate of interest before maturity, disclosure of the period until the next repricing is more important than disclosure of the period to maturity.
66. To supplement the information about contractual repricing and maturity dates, an entity may elect to disclose information about expected repricing or maturity dates when those dates differ significantly from the contractual dates. Such information may be particularly relevant when, for example, an entity is able to predict, with reasonable reliability, the amount of fixed rate mortgage loans that will be repaid prior to maturity and it uses this data as the basis for managing its interest rate risk exposure. The additional information includes disclosure of the fact that it is based on management's expectations of future events and explains the assumptions made about repricing or maturity dates and how those assumptions differ from the contractual dates.
67. An entity indicates which of its financial assets and financial liabilities are:
- (a) Exposed to interest rate price risk, such as monetary financial assets and financial liabilities with a fixed interest rate;
  - (b) Exposed to interest rate cash flow risk, such as monetary financial assets and financial liabilities with a floating interest rate that is reset as market rates change; and
  - (c) Not exposed to interest rate risk, such as some investments in equity securities.
68. The effective interest rate (effective yield) of a monetary financial instrument is the rate that, when used in a present value calculation, results in the carrying amount of the instrument. The present value calculation applies the interest rate to the stream of future cash receipts or payments from the reporting date to the next repricing (maturity) date and to the

expected carrying amount (principal amount) at that date. The rate is a historical rate for a fixed rate instrument carried at amortized cost and a current market rate for a floating rate instrument or an instrument carried at fair value. The effective interest rate is sometimes termed the level yield to maturity or to the next repricing date, and is the internal rate of return of the instrument for that period.

69. The requirement in paragraph 63(b) applies to bonds, notes and similar monetary financial instruments involving future payments that create a return to the holder and a cost to the issuer reflecting the time value of money. The requirement does not apply to financial instruments such as non-monetary and derivative instruments that do not bear a determinable effective interest rate. For example, while instruments such as interest rate derivatives, including swaps, forward rate agreements and options, are exposed to price or cash flow risk from changes in market interest rates, disclosure of an effective interest rate is not relevant. However, when providing effective interest rate information, an entity discloses the effect on its interest rate risk exposure of hedging or conversion transactions such as interest rate swaps.
70. An entity may retain an exposure to the interest rate risks associated with financial assets removed from its statement of financial position as a result of a transaction such as a securitization. Similarly, it may become exposed to interest rate risks as a result of a transaction in which no financial asset or financial liability is recognized on its statement of financial position, such as a commitment to lend funds at a fixed interest rate, or loans to be provided to primary producers during times of drought or other disaster relief. In such circumstances, the entity discloses information that will permit financial statement users to understand the nature and extent of its exposure. In the case of a securitization or similar transfer of financial assets, this information normally includes the nature of the assets transferred, their stated principal, interest rate and term to maturity, and the terms of the transaction giving rise to the retained exposure to interest rate risk. In the case of a commitment to lend funds, the disclosure normally includes the stated principal, interest rate and term to maturity of the amount to be lent and the significant terms of the transaction giving rise to the exposure to risk.
71. The nature of an entity's operations and the extent of its activity in financial instruments will determine whether information about interest rate risk is presented in narrative form, in tables, or by using a combination of the two. When an entity has a significant number of financial instruments exposed to interest rate price or cash flow risks, it may adopt one or more of the following approaches to presenting information.
- (a) The carrying amounts of financial instruments exposed to interest rate price risk may be presented in tabular form, grouped by those that are contracted to mature or be repriced:

- (i) Within one year of the reporting date;
    - (ii) More than one year and less than five years from the reporting date; and
    - (iii) Five years or more from the reporting date.
  - (b) When the performance of an entity is significantly affected by the level of its exposure to interest rate price risk or changes in that exposure, more detailed information is desirable. An entity such as a central borrowing authority may disclose, for example, separate groupings of the carrying amounts of financial instruments contracted to mature or be repriced:
    - (i) Within one month of the reporting date;
    - (ii) More than one and less than three months from the reporting date; and
    - (iii) More than three and less than twelve months from the reporting date.
  - (c) Similarly, an entity may indicate its exposure to interest rate cash flow risk through a table indicating the aggregate carrying amount of groups of floating rate financial assets and financial liabilities maturing within various future time periods.
  - (d) Interest rate information may be disclosed for individual financial instruments or weighted average rates or a range of rates may be presented for each class of financial instrument. An entity groups instruments denominated in different currencies or having substantially different credit risks into separate classes when these factors result in instruments having substantially different effective interest rates.
72. In some circumstances, an entity may be able to provide useful information about its exposure to interest rate risks by indicating the effect of a hypothetical change in the prevailing level of market interest rates on the fair value of its financial instruments and future earnings and cash flows. Such interest rate sensitivity information may be based on an assumed 1% change in market interest rates occurring at the reporting date. The effects of a change in interest rates includes changes in interest revenue and expense relating to floating rate financial instruments and gains or losses resulting from changes in the fair value of fixed rate instruments. The reported interest rate sensitivity may be restricted to the direct effects of an interest rate change on interest-bearing financial instruments on hand at the reporting date since the indirect effects of a rate change on financial markets and individual entities cannot normally be predicted reliably. When disclosing interest rate sensitivity

information, an entity indicates the basis on which it has prepared the information, including any significant assumptions.

### Credit Risk

73. **For each class of financial asset, both recognized and unrecognized, an entity should disclose information about its exposure to credit risk, including:**
- (a) **The amount that best represents its maximum credit risk exposure at the reporting date, without taking account of the fair value of any collateral, in the event other parties fail to perform their obligations under financial instruments; and**
  - (b) **Significant concentrations of credit risk.**
74. An entity provides information relating to credit risk to permit users of its financial statements to assess the extent to which failures by counterparties to discharge their obligations could reduce the amount of future cash inflows from financial assets on hand at the reporting date. Such failures give rise to a financial loss recognized in an entity's statement of financial performance. Paragraph 73 does not require an entity to disclose an assessment of the probability of losses arising in the future.
75. The purposes of disclosing amounts exposed to credit risk without regard to potential recoveries from realization of collateral (an entity's maximum credit risk exposure) are:
- (a) To provide users of financial statements with a consistent measure of the amount exposed to credit risk for both recognized and unrecognized financial assets; and
  - (b) To take into account the possibility that the maximum exposure to loss may differ from the carrying amount of a recognized financial asset or the fair value of an unrecognized financial asset that is otherwise disclosed in the financial statements.
76. In the case of recognized financial assets exposed to credit risk, the carrying amount of the assets in the statement of financial position, net of any applicable provisions for loss, usually represents the amount exposed to credit risk. For example, in the case of an interest rate swap carried at fair value, the maximum exposure to loss at the reporting date is normally the carrying amount since it represents the cost, at current market rates, of replacing the swap in the event of default. In these circumstances, no additional disclosure beyond that provided on the statement of financial position is necessary. On the other hand, as illustrated by the examples in paragraphs 77 and 78, an entity's maximum potential loss from some recognized financial assets may differ significantly from their carrying amount and from other disclosed amounts such as their fair value or

principal amount. In such circumstances, additional disclosure is necessary to meet the requirements of paragraph 73(a).

77. A financial asset subject to a legally enforceable right of set-off against a financial liability is not presented on the statement of financial position net of the liability unless settlement is intended to take place on a net basis or simultaneously. Nevertheless, an entity discloses the existence of the legal right of set-off when providing information in accordance with paragraph 73. For example, when an entity is due to receive the proceeds from realization of a financial asset before settlement of a financial liability of equal or greater amount against which the entity has a legal right of set-off, the entity has the ability to exercise that right of set-off to avoid incurring a loss in the event of a default by the counterparty. However, if the entity responds, or is likely to respond, to the default by extending the term of the financial asset, an exposure to credit risk would exist if the revised terms are such that collection of the proceeds is expected to be deferred beyond the date on which the liability is required to be settled. To inform financial statement users of the extent to which exposure to credit risk at a particular point in time has been reduced, the entity discloses the existence and effect of the right of set-off when the financial asset is expected to be collected in accordance with its terms. When the financial liability against which a right of set-off exists is due to be settled before the financial asset, the entity is exposed to credit risk on the full carrying amount of the asset if the counterparty defaults after the liability has been settled.
78. An entity may have entered into one or more master netting arrangements that serve to mitigate its exposure to credit loss but do not meet the criteria for offsetting. When a master netting arrangement significantly reduces the credit risk associated with financial assets not offset against financial liabilities with the same counterparty, an entity provides additional information concerning the effect of the arrangement. Such disclosure indicates that:
- (a) The credit risk associated with financial assets subject to a master netting arrangement is eliminated only to the extent that financial liabilities due to the same counterparty will be settled after the assets are realized; and
  - (b) The extent to which an entity's overall exposure to credit risk is reduced through a master netting arrangement may change substantially within a short period following the reporting date because the exposure is affected by each transaction subject to the arrangement.

It is also desirable for an entity to disclose the terms of its master netting arrangements that determine the extent of the reduction in its credit risk.

79. When there is no credit risk associated with an unrecognized financial asset or the maximum exposure is equal to the principal, stated, face or other

similar contractual amount of the instrument disclosed in accordance with paragraph 54 or the fair value disclosed in accordance with paragraph 84, no additional disclosure is required to comply with paragraph 73(a). However, with some unrecognized financial assets, the maximum loss that would be recognized upon default by the other party to the underlying instrument may differ substantially from the amounts disclosed in accordance with paragraphs 54 and 84. For example, an entity may have a right to mitigate the loss it would otherwise bear by setting off an unrecognized financial asset against an unrecognized financial liability. In such circumstances, paragraph 73(a) requires disclosure in addition to that provided in accordance with paragraphs 54 and 84.

80. Guaranteeing an obligation of another party exposes the guarantor to credit risk that would be taken into account in making the disclosures required by paragraph 73. This situation may arise as a result of, for example, a securitization transaction in which an entity remains exposed to credit risk associated with financial assets that have been removed from its statement of financial position. If the entity is obligated under recourse provisions of the transaction to indemnify the purchaser of the assets for credit losses, it discloses the nature of the assets removed from its statement of financial position, the amount and timing of the future cash flows contractually due from the assets, the terms of the recourse obligation and the maximum loss that could arise under that obligation. Similarly, where a local government guarantees the obligations of a private sector provider of public infrastructure, the maximum loss that could arise under that obligation in the event of default of the provider should be disclosed.
81. Concentrations of credit risk are disclosed when they are not apparent from other disclosures about the nature and financial position of the entity and they result in a significant exposure to loss in the event of default by other parties. Identification of significant concentrations is a matter for the exercise of judgment by management taking into account the circumstances of the entity and its debtors.
82. Concentrations of credit risk may arise from exposures to a single debtor or to groups of debtors having a similar characteristic such that their ability to meet their obligations is expected to be affected similarly by changes in economic or other conditions. Characteristics that may give rise to a concentration of risk include the nature of the activities undertaken by debtors, such as the industry in which they operate, the geographic area in which activities are undertaken and the level of creditworthiness of groups of borrowers. For example, a state-owned coal mine will normally have trade accounts receivable from sale of its products for which the risk of non-payment is affected by economic changes in the electricity generation industry. A bank that normally lends on an international scale may have a significant amount of loans outstanding to less developed nations and the

bank's ability to recover those loans may be adversely affected by local economic conditions.

83. Disclosure of concentrations of credit risk includes a description of the shared characteristic that identifies each concentration and the amount of the maximum credit risk exposure associated with all recognized and unrecognized financial assets sharing that characteristic.

#### **Fair Value**

84. **For each class of financial asset and financial liability, both recognized and unrecognized, an entity should disclose information about fair value. When it is not practicable within constraints of timeliness or cost to determine the fair value of a financial asset or financial liability with sufficient reliability, that fact should be disclosed together with information about the principal characteristics of the underlying financial instrument that are pertinent to its fair value.**
85. Fair value information is widely used for financial purposes in determining an entity's overall financial position and in making decisions about individual financial instruments. It is also relevant to many decisions made by users of financial statements since, in many circumstances, it reflects the judgment of the financial markets as to the present value of expected future cash flows relating to an instrument. Fair value information permits comparisons of financial instruments having substantially the same economic characteristics, regardless of their purpose and when and by whom they were issued or acquired. Fair values provide a neutral basis for assessing management's stewardship by indicating the effects of its decisions to buy, sell or hold financial assets and to incur, maintain or discharge financial liabilities. When an entity does not carry a financial asset or financial liability in its statement of financial position at fair value, it provides fair value information through supplementary disclosures.
86. The fair value of a financial asset or financial liability may be determined by one of several generally accepted methods. Disclosure of fair value information includes disclosure of the method adopted and any significant assumptions made in its application.
87. Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, curtail materially the scale of its operations or undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, an entity takes its current circumstances into account in determining the fair values of its financial assets and financial liabilities. For example, the fair value of a financial asset that an entity has decided to sell for cash in the immediate future is determined by the amount that it expects to receive

from such a sale. The amount of cash to be realized from an immediate sale will be affected by factors such as the current liquidity and depth of the market for the asset.

88. When a financial instrument is traded in an active and liquid market, its quoted market price provides the best evidence of fair value. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the current offer or asking price. When current bid and offer prices are unavailable, the price of the most recent transaction may provide evidence of the current fair value provided that there has not been a significant change in economic circumstances between the transaction date and the reporting date. When an entity has matching asset and liability positions, it may appropriately use mid-market prices as a basis for establishing fair values.
89. When there is infrequent activity in a market, the market is not well established (for example, some over the counter markets) or small volumes are traded relative to the number of trading units of a financial instrument to be valued, quoted market prices may not be indicative of the fair value of the instrument. In these circumstances, as well as when a quoted market price is not available, estimation techniques may be used to determine fair value with sufficient reliability to satisfy the requirements of this Standard. Techniques that are well established in financial markets include reference to the current market value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. In applying discounted cash flow analysis, an entity uses a discount rate equal to the prevailing market rate of interest for financial instruments having substantially the same terms and characteristics, including the creditworthiness of the debtor, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made.
90. The fair value to an entity of a financial asset or financial liability, whether determined from market value or otherwise, is determined without deduction for the costs that would be incurred to exchange or settle the underlying financial instrument. The costs may be relatively insignificant for instruments traded in organized, liquid markets but may be substantial for other instruments. Transaction costs may include taxes and duties, fees and commissions paid to agents, advisers, brokers or dealers and levies by regulatory agencies or securities exchanges.
91. When an instrument is not traded in an organized financial market, it may not be appropriate for an entity to determine and disclose a single amount that represents an estimate of fair value. Instead, it may be more useful to disclose a range of amounts within which the fair value of a financial instrument is reasonably believed to lie.

92. When disclosure of fair value information is omitted because it is not practicable to determine fair value with sufficient reliability, information is provided to assist users of the financial statements in making their own judgments about the extent of possible differences between the carrying amount of financial assets and financial liabilities and their fair value. In addition to an explanation of the reason for the omission and the principal characteristics of the financial instruments that are pertinent to their value, information is provided about the market for the instruments. In some cases, the terms and conditions of the instruments disclosed in accordance with paragraph 54 may provide sufficient information about the characteristics of the instrument. When it has a reasonable basis for doing so, management may indicate its opinion as to the relationship between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value.
93. The historical cost carrying amount of receivables and payables subject to normal trade credit terms usually approximates fair value. Similarly, the fair value of a deposit liability without a specified maturity is the amount payable on demand at the reporting date.
94. Fair value information relating to classes of financial assets or financial liabilities that are carried on the statement of financial position at other than fair value is provided in a way that permits comparison between the carrying amount and the fair value. Accordingly, the fair values of recognized financial assets and financial liabilities are grouped into classes and offset only to the extent that their related carrying amounts are offset. Fair values of unrecognized financial assets and financial liabilities are presented in a class or classes separate from recognized items and are offset only to the extent that they meet the offsetting criteria for recognized financial assets and financial liabilities.

#### **Financial Assets Carried at an Amount in Excess of Fair Value**

95. **When an entity carries one or more financial assets at an amount in excess of their fair value, the entity should disclose:**
- (a) **The carrying amount and the fair value of either the individual assets or appropriate groupings of those individual assets; and**
  - (b) **The reasons for not reducing the carrying amount, including the nature of the evidence that provides the basis for management's belief that the carrying amount will be recovered.**
96. Management exercises judgment in determining the amount it expects to recover from a financial asset and whether to write down the carrying amount of the asset when it is in excess of fair value. The information required by paragraph 95 provides users of financial statements with a basis for understanding management's exercise of judgment and assessing the

possibility that circumstances may change and lead to a reduction in the asset's carrying amount in the future. When appropriate, the information required by paragraph 95(a) is grouped in a manner that reflects management's reasons for not reducing the carrying amount.

97. An entity's accounting policies with respect to recognition of declines in value of financial assets, disclosed in accordance with paragraph 54, assist in explaining why a particular financial asset is carried at an amount in excess of fair value. In addition, the entity provides the reasons and evidence specific to the asset that provide management with the basis for concluding that the asset's carrying amount will be recovered. For example, the fair value of a fixed rate loan intended to be held to maturity may have declined below its carrying amount as a result of an increase in interest rates. In such circumstances, the lender may not have reduced the carrying amount because there is no evidence to suggest that the borrower is likely to default.

#### **Hedges of Anticipated Future Transactions**

98. **When an entity has accounted for a financial instrument as a hedge of risks associated with anticipated future transactions, it should disclose:**
- (a) **A description of the anticipated transactions, including the period of time until they are expected to occur;**
  - (b) **A description of the hedging instruments; and**
  - (c) **The amount of any deferred or unrecognized gain or loss and the expected timing of recognition as revenue or expense.**
99. An entity's accounting policies indicate the circumstances in which a financial instrument is accounted for as a hedge and the nature of the special recognition and measurement treatment applied to the instrument. The information required by paragraph 98 permits the users of an entity's financial statements to understand the nature and effect of a hedge of an anticipated future transaction. The information may be provided on an aggregate basis when a hedged position comprises several anticipated transactions or has been hedged by several financial instruments.
100. The amount disclosed in accordance with paragraph 98(c) includes all accrued gains and losses on financial instruments designated as hedges of anticipated future transactions, without regard to whether those gains and losses have been recognized in the financial statements. The accrued gain or loss may be unrealized but recorded in the entity's statement of financial position as a result of carrying the hedging instrument at fair value, it may be unrecognized if the hedging instrument is carried on the cost basis, or it may have been realized if the hedging instrument has been sold or settled. In each case, however, the accrued gain or loss on the hedging instrument

has not been recognized in the entity's statement of financial performance pending completion of the hedged transaction.

### **Other Disclosures**

101. Additional disclosures are encouraged when they are likely to enhance financial statement users' understanding of financial instruments. It may be desirable to disclose such information as:
- (a) The total amount of the change in the fair value of financial assets and financial liabilities that has been recognized as revenue or expense for the period;
  - (b) The total amount of deferred or unrecognized gain or loss on hedging instruments other than those relating to hedges of anticipated future transactions; and
  - (c) The average aggregate carrying amount during the year of recognized financial assets and financial liabilities, the average aggregate principal, stated, notional or other similar amount during the year of unrecognized financial assets and financial liabilities and the average aggregate fair value during the year of all financial assets and financial liabilities, particularly when the amounts on hand at the reporting date are unrepresentative of amounts on hand during the year.

### **Transitional Provision**

102. **When comparative information for prior periods is not available when this International Public Sector Accounting Standard is first adopted, such information need not be presented.**

### **Effective Date**

103. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after January 1, 2003. Earlier application is encouraged.**
104. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

## Appendix 1

### Implementation Guide

*This appendix is illustrative only and does not form part of the standards. The purpose of this appendix is to assist preparers of financial statements in identifying those aspects of the Standard that apply to them.*

*This implementation guide should be read jointly with the Standard. Readers are cautioned that the flowcharts and text included in this Guide provide only a broad overview of the requirements of the Standard.*

#### *Requirements of IPSAS 15 — Overview*

All entities will need to review scope paragraphs 1–8 and consult the definition of a financial instrument and related commentary (paragraphs 9v21) to determine when the Standard is applicable and whether they hold financial instruments.

The relevant paragraphs in the Standard for entities with *only* financial assets are paragraphs 48–101 (Disclosure).

The relevant paragraphs in the Standard for entities with *only* financial liabilities are paragraphs 22–28 and 36–38 (Presentation), and paragraphs 48–72, 84–94 and 98–101 (Disclosure).

The relevant paragraphs in the Standard for entities with *only* equity instruments are paragraphs 22–28 and 36–38 (Presentation), and paragraphs 50–62 and 98–101 (Disclosure).

Where entities hold both financial assets and financial liabilities, additional relevant paragraphs are 39–47 (Presentation).

Where entities hold both financial liabilities and net assets/equity, additional relevant paragraphs are 29–35 (Presentation).

Comparative information is required for all instruments (see IPSAS 1, “Presentation of Financial Statements,” paragraphs 60–63) except, if not available, during the year of first adoption (paragraph 102).

#### *Summary of Standard Applicability, Presentation and Disclosure Requirements*

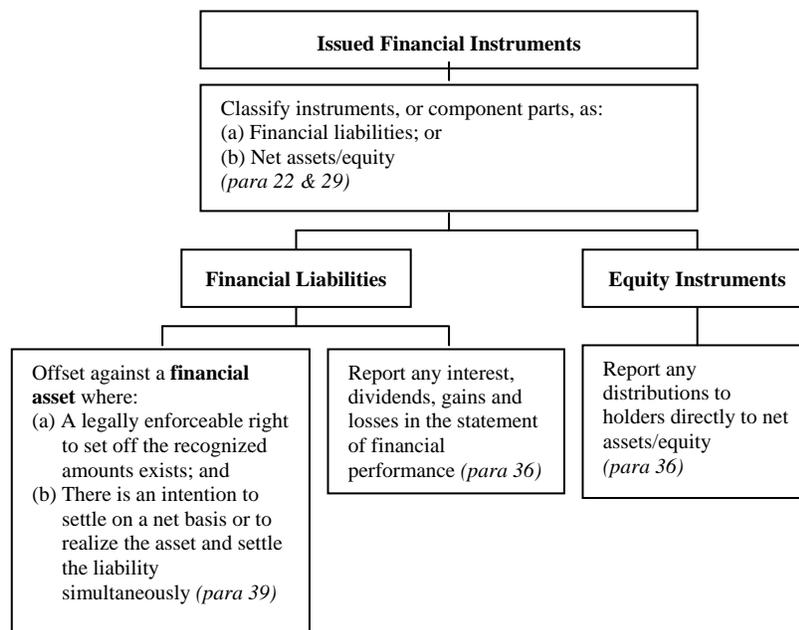
*This section provides an overview of the requirements in respect of financial assets, financial liabilities and equity instruments. The following flowcharts identify key black letter paragraphs of the Standard.*

#### *Scope*

This Standard applies to public sector entities reporting under the accrual basis of accounting. Government Business Enterprises (GBEs) are excluded from the scope of these IPSASs (paragraph 2), however, the “Preface to International Public Sector

Accounting Standards” explains that GBEs apply with IFRSs. This IPSAS also exempts financial instruments of the types identified in paragraph 4 of the Standard from having to comply with the disclosure and presentation rules set out within the Standard. Commentary on these excluded financial instruments can be found in paragraphs 5–8.

### Presentation — Issued Financial Instruments



This Standard sets out the requirements for the presentation of financial instruments. Financial instruments can be classified as being financial assets, financial liabilities or equity instruments. These terms are defined in paragraph 9 of the Standard. Additional discussion clarifying these defined terms and what constitutes a financial instrument is located in commentary paragraphs 10–21. Examples of financial instruments covered by the Standard are included in Appendix 2, paragraphs A3–A16.

#### *Classification*

The Standard requires that the issuer of a financial instrument classify the instrument, or its component parts, as a financial liability or as net assets/equity (paragraph 22). Commentary in paragraphs 23–28 provides users with guidance in distinguishing the nature of the instrument to facilitate consistency in classification across users. Appendix 2, paragraphs A18–A21, provides examples of instruments which should be classified as liabilities or as net assets/equity.

It is likely that few public sector entities will issue compound financial instruments (paragraph 30). The Standard requires that where such instruments are issued, the financial liability and net assets/equity components should be separately classified and disclosed (paragraph 29). Commentary paragraphs 31–33 and Appendix 2, paragraphs A22 and A23, discuss various instances where separate classification is necessary. Paragraphs 34 and 35 set out two methods by which preparers could assign a carrying amount to the various components, and Appendix 2, paragraph A24 illustrates an example of how to assign values to the elements.

#### *Interest, Dividends, Losses and Gains*

The Standard sets out when such items should be classified as revenue or expense, or as a direct debit to net assets/equity (paragraph 36). Further guidance and clarifying comments made regarding these classifications is located within paragraphs 37 and 38.

#### *Offsetting*

The Standard prescribes when an entity should offset a financial asset and a financial liability in the statement of financial position (paragraph 39). Subsequent commentary includes an explanation of the difference between offsetting instruments and ceasing to recognize an instrument (paragraph 41), a discussion of the conditions necessary before an offset is allowable (paragraphs 42–45), and provides examples of situations where offsetting would not be allowable (paragraphs 46 and 47). Paragraph 40 provides an example of where instruments should be offset, noting that in other circumstances, separate presentation consistent with the instrument's characteristics as an asset or liability is appropriate. Appendix 2, paragraph A25, notes that “synthetic instruments” with financial asset and financial liability components should not be offset unless they meet the criteria for offsetting detailed in paragraph 39.

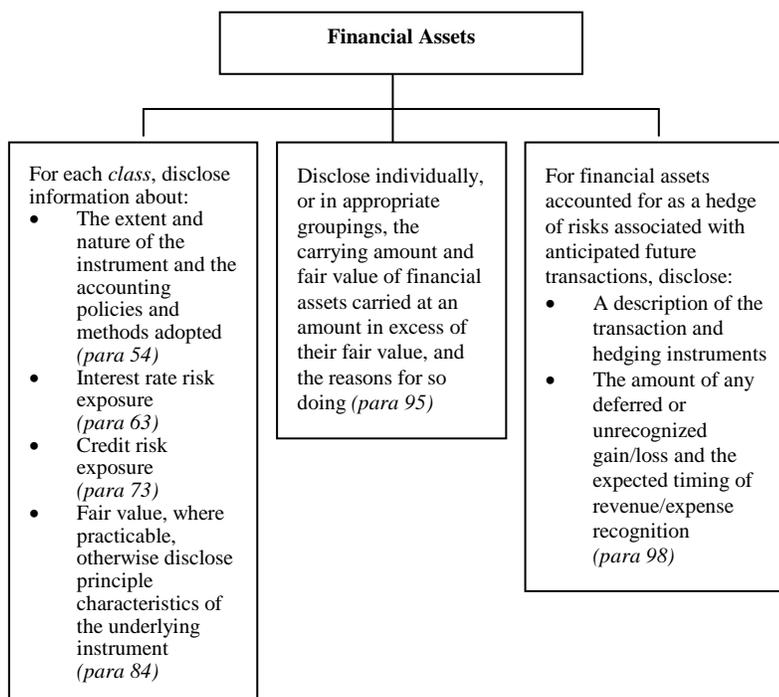
Further discussion pertaining to offsetting and disclosures warranted in those instances is located within paragraphs 77, 78 and 94 of the Standard.

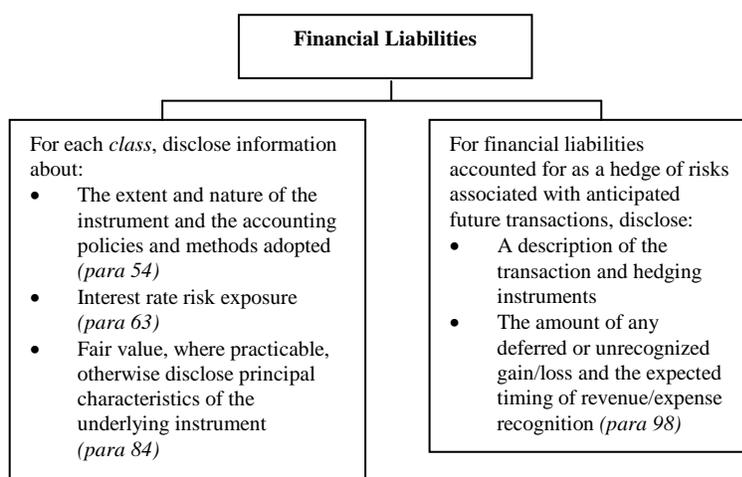
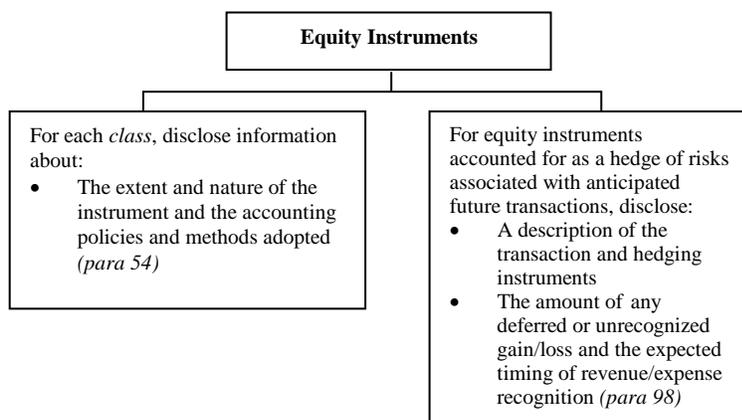
## Disclosure

### Risk Management Policies

The entity should describe its financial risk management objectives and policies (para 50).

### Financial Asset Disclosures



**Financial Liability Disclosures****Equity Instrument Disclosures**

A comprehensive example of the disclosures required of financial instruments under this Standard appears in Appendix 3.

#### *Risk*

A discussion on various forms of risk associated with financial instruments is located in paragraph 49 of the Standard. While the Standard requires disclosure of risk management objectives and policies (paragraph 50), the associated commentary paragraphs 51–53 indicate that aside from the specific inclusion required under paragraph 50, the format, location and level of detail is subject to management's judgement.

#### *Terms, Conditions and Accounting Policies*

The Standard requires disclosure of the extent and nature of financial instruments, and the accounting policies and methods employed (paragraph 54). Commentary paragraphs 55–62, and Appendix 2, paragraphs A26 and A27, provide guidance on the types of information that may be appropriate and instances where disclosure of information is warranted.

#### *Interest Rate Risk*

The reasons for the disclosures about interest rate risk exposure required by paragraph 63 and guidance on the types of information that should be disclosed is located in commentary paragraphs 64–70. Guidance on the presentation of this information is presented in paragraphs 71 and 72.

#### *Credit Risk*

The reasons for the disclosures about credit risk information for the financial assets of the entity is located at paragraph 74 and 75 of the Standard. Commentary paragraphs 76–83 provide readers with examples and discussion of instances where additional credit risk information is desirable or warranted.

#### *Fair Value*

Paragraph 85 explains why the Standard requires the disclosure of fair value information. Discussion regarding the determination of a fair value amount is located at paragraphs 86–91, and at paragraph 93 of the Standard.

Paragraph 84 of the Standard provides preparers with relief from having to disclose fair value information for each class of financial asset and financial liability where it is not practicable with regard to time or cost. Discussion regarding this relief, and the information to be disclosed is found in commentary paragraph 92.

Where classes of financial assets or financial liabilities are carried at other than at their fair value, paragraph 94 notes that information should be provided in a manner that permits comparison between the carrying value and the fair value.

*Financial Assets Carried at an Amount in Excess of Fair Value*

In some instances, management decides not to write down the carrying amount of financial assets to their fair value. Paragraph 95 requires certain disclosures to be made when this occurs. Paragraph 96 and 97 provide discussion of the issue.

*Hedges of Anticipated Future Transactions*

Paragraph 98 requires certain disclosures to be made in respect of financial instruments used for hedging risks related to an anticipated future transaction. Paragraph 99 explains why these disclosures are important. It also explains when such information may be provided on an aggregate basis. Paragraph 100 clarifies the types of items that would be included within paragraph 98(c) pertaining to the disclosure of any deferred or unrecognized gain or loss.

*Other Disclosure*

The Standard encourages preparers to disclose information that would be expected to enhance users' understanding of financial instruments. Examples of such disclosures are included in paragraph 101.

## Appendix 2

### Examples of the Application of the Standard

*This appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.*

- A1. This appendix explains and illustrates the application of certain aspects of the Standard to various common financial instruments. The detailed examples are illustrative only and do not necessarily represent the only basis for applying the Standard in the specific circumstances discussed. Changing one or two of the facts assumed in the examples can lead to substantially different conclusions concerning the appropriate presentation or disclosure of a particular financial instrument. This appendix does not discuss the application of all requirements of the Standard in the examples provided. In all cases, the provisions of the Standard prevail.
- A2. The Standard does not deal with the recognition or measurement of financial instruments. Certain recognition and measurement practices may be assumed for purposes of illustration but they are not required.

### Definitions

#### *Common Types of Financial Instruments, Financial Assets and Financial Liabilities*

- A3. Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and reported in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a check or similar instrument against the balance in favor of a creditor in payment of a financial liability.
- A4. Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:
  - (a) Trade accounts receivable and payable;
  - (b) Notes receivable and payable;
  - (c) Loans receivable and payable; and
  - (d) Bonds receivable and payable.

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

- A5. Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in highly rated bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver bonds, not cash. The bonds are financial assets because they represent obligations of the issuer to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.
- A6. Under IPSAS 13, a finance lease is accounted for as a sale with delayed payment terms. The lease contract is considered to be primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is considered to be primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself rather than any amount receivable in the future under the contract. Accordingly, a finance lease is considered to be a financial instrument and an operating lease is considered not to be a financial instrument (except as regards individual payments currently due and payable).

#### *Equity Instruments*

- A7. Equity instruments are not commonly issued by public sector entities except for partly-privatized GBEs. Examples of equity instruments include common shares, certain types of preferred shares, and warrants or options to subscribe for or purchase common shares in the issuing entity. An entity's obligation to issue its own equity instruments in exchange for financial assets of another party is not potentially unfavorable since it results in an increase in net assets/equity and cannot result in a loss to the entity. The possibility that existing holders of a net assets/equity interest in the entity may find the fair value of their interest reduced as a result of the obligation does not make the obligation unfavorable to the entity itself.
- A8. An option or other similar instrument acquired by an entity that gives it the right to reacquire its own equity instruments is not a financial asset of the entity. The entity will not receive cash or any other financial asset through exercise of the option. Exercise of the option is not potentially favorable to the entity since it results in a reduction in net assets/equity and an outflow of assets. Any change in net assets/equity recorded by the entity from reacquiring and canceling its own equity instruments represents a transfer between those holders of equity instruments who have given up their net assets/equity interest and those who continue to hold a net assets/equity interest, rather than a gain or loss by the entity.

*Derivative Financial Instruments*

- A9. On inception, derivative financial instruments give one party a contractual right to exchange financial assets with another party under conditions that are potentially favorable, or a contractual obligation to exchange financial assets with another party under conditions that are potentially unfavorable. Some instruments embody both a right and an obligation to make an exchange. Since the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change, those terms may become either favorable or unfavorable.
- A10. A put or call option to exchange financial instruments gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the contract. Conversely, the writer of an option assumes an obligation to forego potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability respectively. The financial instrument underlying an option contract may be any financial asset, including shares and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would still constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the assets under potentially favorable conditions and the writer's obligation to exchange the assets under potentially unfavorable conditions are distinct from the underlying assets to be exchanged upon exercise of the option. The nature of the holder's right and the writer's obligation is not affected by the likelihood that the option will be exercised. An option to buy or sell an asset other than a financial asset (such as a commodity) does not give rise to a financial asset or financial liability because it does not fit the requirements of the definitions for the receipt or delivery of financial assets or exchange of financial instruments.
- A11. Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver 1,000,000 cash in exchange for 1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver 1,000,000 face amount of fixed rate government bonds in exchange for 1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above 1,000,000, the conditions will be favorable to the purchaser and unfavorable to the seller; if the market price falls below 1,000,000, the effect will be the opposite. The purchaser has both a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a

contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). The significant difference between a forward contract and an option contract is that both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.

- A12. Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardized and traded on an exchange.

*Commodity Contracts and Commodity-linked Financial Instruments*

- A13. As indicated by paragraph 18 of the Standard, contracts that provide for settlement by receipt or delivery of a physical asset only (for example, an option, futures or forward contract on silver) are not financial instruments. Many commodity contracts are of this type. Some are standardized in form and traded on organized markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be readily bought and sold for cash because it is listed for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument.
- A14. A contract that involves receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on trade credit.
- A15. Some contracts are commodity-linked but do not involve settlement through physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a

formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price but is settled only in cash. Such a contract constitutes a financial instrument.

- A16. The definition of a financial instrument encompasses also a contract that gives rise to a non-financial asset or liability in addition to a financial asset or liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset. For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time based on the fair value of oil relative to the exchange ratio of cash for oil (the exchange price) inherent in the bond. The intentions of the bondholder concerning the exercise of the option do not affect the substance of the component assets. The financial asset of the holder and the financial liability of the issuer make the bond a financial instrument, regardless of the other types of assets and liabilities also created.
- A17. Although the Standard was not developed to apply to commodity or other contracts that do not satisfy the definition of a financial instrument, entities may consider whether it is appropriate to apply the relevant portions of the disclosure standards to such contracts.

#### **Liabilities and Net Assets/Equity**

- A18. Although it is not common for public sector entities to issue equity instruments, in the event that such instruments are issued, it is relatively easy for issuers to classify certain types of financial instruments as liabilities or net assets/equity. Examples of equity instruments include common (ordinary) shares and options that, if exercised, would require the writer of the option to issue common shares. Common shares do not oblige the issuer to transfer assets to shareholders, except when the issuer formally acts to make a distribution and becomes legally obligated to the shareholders to do so. This may be the case following declaration of a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

#### *“Perpetual” Debt Instruments*

- A19. “Perpetual” debt instruments, such as “perpetual” bonds, debentures and capital notes, normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very

far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8% applied to a stated par or principal amount of 1,000. Assuming 8% to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of 1,000. The holder and issuer of the instrument have a financial asset and financial liability, respectively, of 1,000 and corresponding interest revenue and expense of 80 each year in perpetuity.

#### *Preferred Shares*

- A20. Preferred (or preference) shares may be issued with various rights. In classifying a preferred share as a liability or net assets/equity, an entity assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preferred share that provides for redemption on a specific date or at the option of the holder meets the definition of a financial liability if the issuer has an obligation to transfer financial assets to the holder of the share. The inability of an issuer to satisfy an obligation to redeem a preferred share when contractually required to do so, whether due to a lack of funds or a statutory restriction, does not negate the obligation. An option of the issuer to redeem the shares does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. Redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.
- A21. When preferred shares are non-redeemable, the appropriate classification is determined by the other rights that may attach to them. When distributions to holders of the preferred shares whether, cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments.

#### *Compound Financial Instruments*

- A22. Paragraph 29 of the Standard applies only to a limited group of compound instruments for the purpose of having the issuers present liability and equity instrument components separately on their statements of financial position. Paragraph 29 does not deal with compound instruments from the perspective of holders.
- A23. A common form of compound financial instrument is a debt security with an embedded conversion option, such as a bond convertible into common shares of the issuer. Paragraph 29 of the Standard requires the issuer of such a financial instrument to present the liability component and the equity

instrument component separately on the statement of financial position from their initial recognition.

- (a) The issuer's obligation to make scheduled payments of interest and principal constitutes a financial liability which exists as long as the instrument is not converted. On inception, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied by the market at that time to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.
- (b) The equity instrument is an embedded option to convert the liability into net assets/equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. The intrinsic value of an option or other derivative financial instrument is the excess, if any, of the fair value of the underlying financial instrument over the contractual price at which the underlying instrument is to be acquired, issued, sold or exchanged. The time value of a derivative instrument is its fair value less its intrinsic value. The time value is associated with the length of the remaining term to maturity or expiry of the derivative instrument. It reflects the revenue foregone by the holder of the derivative instrument from not holding the underlying instrument, the cost avoided by the holder of the derivative instrument from not having to finance the underlying instrument and the value placed on the probability that the intrinsic value of the derivative instrument will increase prior to its maturity or expiry due to future volatility in the fair value of the underlying instrument. It is uncommon for the embedded option in a convertible bond or similar instrument to have any intrinsic value on issuance.

- A24. Paragraph 34 of the Standard describes how the components of a compound financial instrument may be valued on initial recognition. The following example illustrates in greater detail how such valuations may be made.

An entity issues 2,000 convertible bonds at the start of Year 1. The bonds have a three-year term, and are issued at par with a face value of 1,000 per bond, giving total proceeds of 2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6%. Each bond is convertible at any time up to maturity into 250 common shares.

When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9%. At the issue date, the market price of one common share is 3. The dividends expected over the three-year term of the bonds amount to 0.14 per share at the end of each year. The risk-free annual interest rate for a three-year term is 5%.

*Residual Valuation of Equity Instrument Component:*

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

Present value of the principal — 2,000,000 payable at the end of three years	1,544,367
Present value of the interest — 120,000 payable annually in arrears for three years	<u>303,755</u>
Total liability component	1,848,122
Equity instrument component (by deduction)	<u>151,878</u>
Proceeds of the bond issue	<u><u>2,000,000</u></u>

*Option Pricing Model Valuation of Net Assets/Equity Component:*

Option pricing models may be used to determine the fair value of conversion options directly rather than by deduction as illustrated above. Option pricing models are often used by financial institutions for pricing day-to-day transactions. There are a number of models available, of which the Black-Scholes model is one of the most well-known, and each has a number of variants. The following example illustrates the application of a version of the Black-Scholes model that utilizes tables available in finance textbooks and other sources. The steps in applying this version of the model are set out below.

This model first requires the calculation of two amounts that are used in the option valuation tables:

- (a) Standard deviation of proportionate changes in the fair value of the asset underlying the option multiplied by the square root of the time to expiry of the option.

This amount relates to the potential for favorable (and unfavorable) changes in the price of the asset underlying the option, in this case the common shares of the entity issuing the convertible bonds. The volatility of the returns on the underlying asset are estimated by the standard deviation of the returns. The higher the standard deviation, the greater the fair value of the option. In this example, the standard deviation of the annual returns on the shares is assumed to be 30%. The time to expiry of the conversion rights is three years. The standard deviation of proportionate changes in fair value of the

shares multiplied by the square root of the time to expiry of the option is thus determined as:

$$0.3 \times \sqrt{3} = \underline{0.5196}$$

- (b) Ratio of the fair value of the asset underlying the option to the present value of the option exercise price.

This amount relates the present value of the asset underlying the option to the cost that the option holder must pay to obtain that asset, and is associated with the intrinsic value of the option. The higher this amount, the greater the fair value of a call option. In this example, the market value of each share on issuance of the bonds is 3. The present value of the expected dividends over the term of the option is deducted from the market price, since the payment of dividends reduces the fair value of the shares and thus the fair value of the option. The present value of a dividend of 0.14 per share at the end of each year, discounted at the risk-free rate of 5%, is 0.3813. The present value of the asset underlying the option is therefore:

$$3 - 0.3813 = 2.6187 \text{ per share}$$

The present value of the exercise price is 4 per share discounted at the risk-free rate of 5% over three years, assuming that the bonds are converted at maturity, or 3.4554. The ratio is thus determined as:

$$2.6187 \div 3.4554 = \underline{0.7579}$$

The bond conversion option is a form of call option. The call option valuation table indicates that, for the two amounts calculated above (i.e., 0.5196 and 0.7579), the fair value of the option is approximately 11.05% of the fair value of the underlying asset.

The valuation of the conversion options can therefore be calculated as:

$$0.1105 \times 2.6187 \text{ per share} \times 250 \text{ shares per bond} \times 2,000 \text{ bonds} = \underline{144,683}$$

The fair value of the debt component of the compound instrument calculated above by the present value method plus the fair value of the option calculated by the Black–Scholes option pricing model does not equal the 2,000,000 proceeds from issuance of the convertible bonds (i.e., 1,848,122 + 144,683 = 1,992,805). The small difference can be prorated over the fair values of the two components to produce a fair value for the liability of 1,854,794 and a fair value for the option of 145,206.

**Offsetting of a Financial Asset and a Financial Liability**

A25. The Standard does not provide special treatment for so-called “synthetic instruments,” which are groupings of separate financial instruments acquired and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesizes a fixed rate long-term debt. Each of the separate components of a “synthetic instrument” represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each component is exposed to risks that may differ from the risks to which other components are exposed. Accordingly, when one component of a “synthetic instrument” is an asset and another is a liability, they are not offset and presented on an entity’s statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 39 of the Standard. Such is often not the case. Disclosures are provided about the significant terms and conditions of each financial instrument constituting a component of a “synthetic instrument” without regard to the existence of the “synthetic instrument,” although an entity may indicate in addition the nature of the relationship between the components (see paragraph 58 of the Standard).

**Disclosure**

A26. Paragraph 60 of the Standard lists examples of broad categories of matters that, when significant, an entity addresses in its disclosure of accounting policies. In each case, an entity has a choice from among two or more different accounting treatments. The following discussion elaborates on the examples in paragraph 60 and provides further examples of circumstances in which an entity discloses its accounting policies.

- (a) An entity may acquire or issue a financial instrument under which the obligations of each party are partially or completely unperformed (sometimes referred to as an unexecuted or executory contract). Such a financial instrument may involve a future exchange and performance may be conditional on a future event. For example, neither the right nor the obligation to make an exchange under a forward contract results in any transaction in the underlying financial instrument until the maturity of the contract but the right and obligation constitute a financial asset and a financial liability, respectively. Similarly, a financial guarantee does not require the guarantor to assume any obligation to the holder of the guaranteed debt until an event of default has occurred. The guarantee is, however, a financial liability of the guarantor because it is a contractual obligation to exchange one financial instrument (usually cash) for another (a receivable from the defaulted debtor) under conditions that are potentially unfavorable.

- (b) An entity may undertake a transaction that, in form, constitutes a direct acquisition or disposition of a financial instrument but does not involve the transfer of the economic interest in it. Such is the case with some types of repurchase and reverse repurchase agreements. Conversely, an entity may acquire or transfer to another party an economic interest in a financial instrument through a transaction that, in form, does not involve an acquisition or disposition of legal title. For example, in a non-recourse borrowing, an entity may pledge accounts receivable as collateral and agree to use receipts from the pledged accounts solely to service the loan.
- (c) An entity may undertake a partial or incomplete transfer of a financial asset. For example, in a securitization, an entity acquires or transfers to another party some, but not all, of the future economic benefits associated with a financial instrument.
- (d) An entity may be required, or intend, to link two or more individual financial instruments to provide specific assets to satisfy specific obligations. Such arrangements include, for example, “in substance” defeasance trusts in which financial assets are set aside for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation, non-recourse secured financing and sinking fund arrangements.
- (e) An entity may use various risk management techniques to minimize exposures to financial risks. Such techniques include, for example, hedging, interest rate conversion from floating rate to fixed rate or fixed rate to floating rate, risk diversification, risk pooling, guarantees and various types of insurance (including sureties and “hold harmless” agreements). These techniques generally reduce the exposure to loss from only one of several different financial risks associated with a financial instrument and involve the assumption of additional but only partially offsetting risk exposures.
- (f) An entity may link two or more separate financial instruments together notionally in a “synthetic instrument” or for some purposes other than those described in items (d) and (e) above.
- (g) An entity may acquire or issue a financial instrument in a transaction in which the amount of the consideration exchanged for the instrument is uncertain. Such transactions may involve non-cash consideration or an exchange of several items.
- (h) An entity may acquire or issue a bond, promissory note or other monetary instrument with a stated amount or rate of interest that differs from the prevailing market interest rate applicable to the instrument. Such financial instruments include zero coupon bonds and

loans made on apparently favorable terms but involving non-cash consideration, for example, low interest rate loans to employees.

- A27. Paragraph 61 of the Standard lists several issues that an entity addresses in its disclosure of accounting policies when the issues are significant to the application of the cost basis of measurement. In the case of uncertainty about the collectibility of amounts realizable from a monetary financial asset or a decline in the fair value of a financial asset below its carrying amount due to other causes, an entity indicates its policies for determining:
- (a) When to reduce the carrying amount of the asset;
  - (b) The amount to which it reduces the carrying amount;
  - (c) How to recognize any revenue from the asset; and
  - (d) Whether the reduction in carrying amount may be reversed in the future if circumstances change.

## Appendix 3

### Examples of Disclosure Requirements

*This appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards and to assist in clarifying their meaning. The appendix illustrates an economic entity which includes a number of partly-privatized GBEs that have issued convertible notes and preference shares.*

#### **Note X1. Summary of Accounting Policies (Extract)**

##### *Trade Receivables*

Trade receivables are carried at original invoice amount less an estimate made for doubtful receivables based on a review of all outstanding amounts at the year end. Bad debts are written off when identified.

##### *Investments*

Interests in listed and unlisted securities, other than controlled entities and associates in the consolidated financial statements, are recognized at cost and dividend revenue is recognized in the statement of financial performance when receivable.

The principal amount of zero coupon bonds is calculated by discounting the cash flow associated with the ultimate redemption of the investment. The discount is amortized over the period to maturity. The discount rate is that implicit in the transaction.

##### *Borrowings*

Loans and debentures are carried at their principal amounts which represent the present value of future cash flows associated with servicing the debt. Interest is accrued over the period it becomes due and is recorded as part of other creditors.

On issue of convertible notes, the fair value of the liability component, being the obligation to make future payments of principal and interest to noteholders, is calculated using a market interest rate for an equivalent non-convertible note. The residual amount, representing the fair value of the conversion option, is included in equity as other equity securities with no recognition of any change in the value of the option in subsequent periods. The liability is included in borrowings and carried on an amortized cost basis with interest on the notes recognized as borrowing costs on an effective yield basis until the liability is extinguished on conversion or maturity of the notes.

Redeemable preference shares which provide for mandatory redemption or which are redeemable at the option of the holder are included in liabilities as they are, in substance, borrowings. Dividends payable on the shares are recognized in the statement of financial performance as interest and finance charges on an accruals basis.

*Derivative Financial Instruments*

The entity enters into forward foreign exchange contracts and interest rate swap agreements.

The net amount receivable or payable under interest rate swap agreements is progressively recognized over the period to settlement. The amount recognized is accounted for as an adjustment to interest and finance charges during the period and included in other debtors or other creditors at each reporting date.

**Note X2. Financial Risk Management***Financial Risk Factors*

The entity's activities expose it to a variety of financial risks, including the effects of: changes in debt and equity market prices, foreign currency exchange rates and interest rates. The entity's overall risk management program focuses on the unpredictability of financial markets and seeks to minimize potential adverse effects on the financial performance of the entity. The entity uses derivative financial instruments such as interest rate swaps and foreign exchange contracts to hedge certain exposures.

Risk management is carried out by a central treasury agency (Treasury Corporation) under policies approved by its Governing Board and consistent with the prudential guidelines set down by the Ministry for Finance. Treasury Corporation identifies, evaluates and hedges financial risks in close co-operation with the operating units. The Board provides written principles for overall risk management, as well as written policies covering specific areas, such as foreign exchange risk, interest rate risk, credit risk, use of derivative financial instruments and investing excess liquidity.

*Interest Rate Risk*

The entity's revenue and operating cash flows are substantially independent of changes in market interest rates. The entity has no significant interest-bearing assets. The entity's policy is to maintain approximately 80% of its borrowings in fixed rate instruments. At the year end 75% were at fixed rates. The entity sometimes borrows at variable rates and uses interest rate swaps as cash flow hedges of future interest payments, which have the economic effect of converting borrowings from floating rates to fixed rates. The interest rate swaps allow the entity to raise long-term borrowings at floating rates and swap them into fixed rates that are lower than those available if it borrowed at fixed rates directly. Under the interest rate swaps, the entity agrees with other parties to exchange, at specified intervals (mainly quarterly), the difference between fixed contract rates and floating rate interest amounts calculated by reference to the agreed notional principal amounts.

*Credit Risk*

The entity has no significant concentrations of credit risk. Derivative counterparties and cash transactions are limited to high credit quality financial institutions. The

entity has policies that limit the amount of credit exposure to any one financial institution.

#### *Liquidity Risk*

Prudent liquidity risk management includes maintaining sufficient cash and marketable securities, the availability of funding through an adequate amount of committed credit facilities and the ability to close out market positions. Treasury Corporation aims at maintaining flexibility in funding by keeping committed credit lines available.

#### *Fair Value Estimation*

The fair value of publicly traded derivatives and trading and available-for-sale securities is based on quoted market prices at the reporting date. The fair value of interest rate swaps is calculated as the present value of the estimated future cash flows. The fair value of forward foreign exchange contracts is determined using forward exchange market rates at the reporting date.

In assessing the fair value of non-traded derivatives and other financial instruments, the entity uses a variety of methods and makes assumptions that are based on market conditions existing at each reporting date. Quoted market prices or dealer quotes for the specific or similar instruments are used for long-term debt. Other techniques, such as option pricing models and estimated discounted value of future cash flows, are used to determine fair value for the remaining financial instruments.

The face values less any estimated credit adjustments for financial assets and liabilities with a maturity of less than one year are assumed to approximate their fair values. The fair value of financial liabilities for disclosure purposes is estimated by discounting the future contractual cash flows at the current market interest rate available to the entity for similar financial instruments.

### **Note X3. Financial Instruments**

#### (i) *Off-balance-sheet Derivative Instruments*

The entity is party to derivative financial instruments in the normal course of its operations in order to hedge exposure to fluctuations in interest and foreign exchange rates.

#### *Interest Rate Swap Contracts*

Loans of the entity currently bear an average variable interest rate of 8.5%. It is policy to protect part of the loans from exposure to increasing interest rates. Accordingly, the entity has entered into interest rate swap contracts under which it is obliged to receive interest at variable rates and to pay interest at fixed rates. The contracts are settled on a net basis and the net amount receivable or payable at the reporting date is included in other debtors or other creditors.

The contracts require settlement of net interest receivable or payable each 90 days. The settlement dates coincide with the dates on which interest is payable on the underlying debt.

Swaps currently in place cover approximately 60% (20X1–40%) of the loan principal outstanding and are timed to expire as each loan repayment falls due. The fixed interest rates range between 7.8% and 8.3% (20X1–9.0% and 9.6%) and the variable rates are between 0.5% and 1.0% above the 90 day bank bill rate which at the reporting date was 8.2% (20X1–9.4%).

At 30 June 20X2, the notional principal amounts and periods of expiry of the interest rate swap contracts are as follows:

	<b>20X2</b>	<b>20X1</b>
	<b>\$'000</b>	<b>\$'000</b>
Less than 1 year	<b>30</b>	20
1–2 years	<b>250</b>	170
2–3 years	<b>250</b>	170
3–4 years	<b>300</b>	80
4–5 years	<b>180</b>	–
	<b>1,010</b>	440

#### *Forward Exchange Contracts*

The passenger rail system is being substantially upgraded. New rolling stock is being purchased from Country A and Country B. In order to protect against exchange rate movements, the entity has entered into forward exchange contracts to purchase Foreign Currency A (FCA) and Foreign Currency B (FCB).

The contracts are timed to mature when major shipments of rolling stock are scheduled to arrive and cover anticipated purchases for the ensuing financial year.

At the reporting date, the details of outstanding contracts are:

Buy FC <sub>A</sub>	Sell Domestic	Currency	Average exchange rate	
	20X2	20X1	20X2	20X1
	\$'000	\$'000		
Maturity				
0–6 months	<b>2,840</b>	3,566	<b>0.7042</b>	0.7010
6–12 months	<b>4,152</b>	1,466	<b>0.7225</b>	0.6820
Buy FC <sub>B</sub>	Sell Domestic	Currency	Average exchange rate	
	20X2	20X1	20X2	20X1
	\$'000	\$'000		
Maturity				
0–6 months	<b>4,527</b>	2,319	<b>0.6627</b>	0.6467
6–12 months	–	1,262	–	0.6337

As these contracts are hedging anticipated future purchases, any unrealized gains and losses on the contracts, together with the cost of the contracts, are deferred and will be recognized in the measurement of the underlying transaction. Included in the amounts deferred are any gains and losses on hedging contracts terminated prior to maturity where the related hedged transaction is still expected to occur.

(ii) *Credit Risk Exposures*

The credit risk on financial assets of the entity which have been recognized on the statement of financial position, other than investments in shares, is generally the carrying amount, net of any provisions for doubtful debts.

Bills of exchange and zero coupon bonds which have been purchased at a discount to face value, are carried on the statement of financial position at an amount less than the amount realizable at maturity. The total credit risk exposure of the entity could also be considered to include the difference between the carrying amount and the realizable amount.

The recognized financial assets of the consolidated entity include amounts receivable arising from unrealized gains on derivative financial instruments. For off-balance-sheet financial instruments, including derivatives, which are deliverable, credit risk also arises from the potential failure of counterparties to meet their obligations under the respective contracts at maturity. A material exposure arises from forward exchange contracts and the consolidated entity is exposed to loss in the event that counterparties fail to deliver the contracted amount. At the reporting date the following amounts are receivable (domestic currency equivalents):

	<b>20X2</b>	20X1
	<b>\$'000</b>	\$'000
Domestic Currency	<b>2,073</b>	1,422
Foreign Currency	<b>11,599</b>	8,613

*(iii) Interest Rate Risk Exposures*

The entity's exposure to interest rate risk and the effective weighted average interest rate by maturity periods is set out in the following table. For interest rates applicable to each class of asset or liability refer to individual notes to the financial statements [not shown here].

Exposures arise predominantly from assets and liabilities bearing variable interest rates as the entity intends to hold fixed rate assets and liabilities to maturity.

*(iv) Net Fair Value of Financial Assets and Liabilities*

*On-balance-sheet*

The net fair value of cash and cash equivalents and non-interest bearing monetary financial assets and financial liabilities of the entity approximates their carrying amounts.

The net fair value of other monetary financial assets and financial liabilities is based upon market prices where a market exists or by discounting the expected future cash flows by the current interest rates for assets and liabilities with similar risk profiles.

Equity investments traded on organized markets have been valued by reference to market prices prevailing at the reporting date. For non-traded equity investments, the net fair value is an assessment by the Treasury Corporation based on the underlying net assets, future maintainable earnings and any special circumstances pertaining to a particular investment.

*Off-balance-sheet*

The entity has been indemnified against any losses which might be incurred in relation to shares in certain non-government corporations. The net fair value of the indemnity has been taken to be the difference between the carrying amount and the net fair value of the shares.

The call option granting an unrelated party an option to acquire the entity's interest Inter-Provincial Airlines is out-of-the money and the net fair value is immaterial.

Debentures which were the subject of an in-substance defeasance and for which the entity has guaranteed repayment have a net fair value equal to their face value.

The net fair value of financial assets or financial liabilities arising from interest rate swap agreements has been determined as the carrying amount, which represents the amount currently receivable or payable at the reporting date, and the present value of the estimated future cash flows which have not been recognized as an asset or liability.

For forward exchange contracts, the net fair value is taken to be the unrealized gain or loss at the reporting date calculated by reference to the current forward rates for contracts with similar maturity profiles.

The entity has potential financial liabilities which may arise from certain contingencies. No material losses are anticipated in respect of any of those contingencies and the net fair value disclosed below is the Ministry for Finance's estimate of amounts which would be payable by the entity as consideration for the assumption of those contingencies by another party.

The carrying amount and net fair values of financial assets and financial liabilities at the reporting date are:

	20X2		20X1	
	Carrying amount	Net fair value	Carrying amount	Net fair value
	\$'000	\$'000	\$'000	\$'000
<b>On-balance-sheet financial instruments</b>				
<b>Financial assets</b>				
Cash	250	250	200	200
Deposits	3,952	3,952	2,881	2,881
Trade debtors	5,374	5,374	3,935	3,935
Bills of exchange	440	437	140	140
Loans to directors	147	121	136	107
Other debtors	424	425	124	124
Loans to related parties	800	800	200	200
Shares in other related parties	200	227	200	227
Shares in other corporations	100	100	200	190
Zero coupon bonds	60	58	–	–
	<b>11,747</b>	<b>11,744</b>	8,016	8,004
<b>Non-traded financial assets</b>				
<b>Traded investments</b>				
Shares in non-government corporations	1,100	900	100	60
Debentures	200	215	–	–
	<b>13,047</b>	<b>12,859</b>	8,116	8,064
<b>Financial liabilities</b>				
Trade creditors	2,405	2,405	1,762	1,762
Other creditors	740	740	650	650
Bank overdraft	2,350	2,350	2,250	2,250
Bank loans	530	537	900	898
Bills payable	250	241	130	130
Convertible notes	1,800	1,760	–	–
Redeemable preference shares	1,000	875	1,000	860
Other loans	430	433	150	150
Lease liabilities	575	570	650	643
<b>Non-traded financial liabilities</b>	<b>10,080</b>	<b>9,911</b>	7,492	7,343
<b>Off-balance-sheet financial instruments</b>	<b>2,000</b>	<b>2,072</b>	3,000	3,018
<b>Financial assets</b>	<b>12,080</b>	<b>11,983</b>	10,492	10,361

FINANCIAL INSTRUMENTS: DISCLOSURE AND PRESENTATION

Indemnity received	– <sup>(i)</sup>	<b>200</b>	– <sup>(i)</sup>	40
Forward exchange contracts	<b>61</b> <sup>(ii)</sup>	<b>61</b>	26	26
Interest rate swaps	<b>2</b> <sup>(ii)</sup>	<b>13</b>	1	2
	<b>63</b>	<b>274</b>	27	68

**Financial liabilities**

Call options	–	–	–	–
Debentures defeased	–	<b>1,000</b>	–	–
Forward exchange contracts	<b>607</b> <sup>(ii)</sup>	<b>402</b>	304	231
Contingencies	–	<b>25</b>	–	30
	<b>607</b>	<b>1,427</b>	304	261

(i) Included in the carrying amount of traded investments above.

(ii) The carrying amounts are unrealized gains or losses which have been included in the on-balance-sheet financial assets and liabilities disclosed above.

Other than those classes of assets and liabilities denoted as “traded,” none of the classes of financial assets and liabilities are readily traded on organized markets in standardized form.

Although certain financial assets are carried at an amount above net fair value, the Governing Board has not caused those assets to be written down as it is intended to retain those assets to maturity.

Net fair value is exclusive of costs which would be incurred on realization of an asset, and inclusive of costs which would be incurred on settlement of a liability.

### Comparison with IAS 32

IPSAS 15, “Financial Instruments: Disclosure and Presentation” is drawn primarily from IAS 32 (revised 1998), “Financial Instruments: Disclosure and Presentation.” The main differences between IPSAS 15 and IAS 32 are as follows:

- IAS 32 was amended in October 2000 to eliminate disclosure requirements that became redundant as a result of Internal Accounting Standard (IAS) 39, “Financial Instruments: Recognition and Measurement.” As yet, there is no IPSAS addressing the issue of the recognition and measurement of financial instruments. Consequently, the sections on Hedges of Anticipated Future Transactions and Other Disclosures have been retained in IPSAS 15.
- Commentary additional to that in IAS 32 has been included in IPSAS 15 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 15 uses different terminology, in certain instances, from IAS 32. The most significant examples are the use of the terms entity, revenue, statement of financial performance, statement of financial position (except for references to on- and off-balance-sheet) and net assets/equity (except for references to equity instruments) in IPSAS 15. The equivalent terms in IAS 32 are enterprise, income, income statement, balance sheet and equity.
- IPSAS 15 includes a definition of an insurance contract. Insurance contracts are only explained in commentary in IAS 32.
- IPSAS 15 includes an implementation guide to assist preparers of financial statements (Appendix 1). IAS 32 does not include such a guide.
- IPSAS 15 includes an illustration of the disclosures required under the Standard (Appendix 3). No example of disclosure requirements is included in IAS 32.

## **IPSAS 16—INVESTMENT PROPERTY**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 40 (Revised 2003), “Investment Property” published by the International Accounting Standards Board (IASB). Extracts from IAS 40 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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16) is set out in paragraphs 1-103. All the paragraphs have equal authority. IPSAS 16 should be read in the context of its objective, the Basis for Conclusion, and the “Preface to International Public Sector Accounting Standards.” IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## **Introduction**

IN1. International Public Sector Accounting Standard (IPSAS) 16, “Investment Property,” replaces IPSAS 16, “Investment Property” (issued December 2001), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## **Reasons for Revising IPSAS 16**

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 16 as a response to the International Accounting Standards Board’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 16, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 40, “Investment Property” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 40 for a public sector specific reason; such variances are retained in this IPSAS 16 and are noted in the Comparison with IAS 40. Any changes to IAS 40 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 16.

## **Changes from Previous Requirements**

IN4. The main changes from the previous version of IPSAS 16 are described below.

## **Property Interests Held by a Lessee under an Operating Lease**

IN5. The Standard allows in paragraph 8 a property interest held by a lessee under an operating lease to be classified and accounted for as investment property provided certain criteria are met.

IN6. The Standard requires a lessee that classifies a property interest held under an operating lease as investment property to account for the lease as if it were a finance lease in accordance with IPSAS 13 “Leases,” i.e., the asset shall be recognized at the lower of the fair value of the property interest and the present value of the minimum lease payments. The fair value is determined by reference to that interest and not the underlying property (see paragraphs 34-35).

IN7. The Standard specifies that the subsequent measurement choice between cost model and fair value model is not available for a lessee accounting for a property interest held under an operating lease that it has elected to classify as investment property. Such investment property is required to be measured using the fair value model. Once this alternative is selected for one such property, all other properties classified as investment properties held by the

entity are to be accounted for consistently on a fair value basis (see paragraphs 42-43).

IN8. Previously, IPSAS 16 did not contain these requirements.

### **Changes to Reflect Equivalent Requirements in Proposed IPSAS 17 Property, Plant and Equipment**

IN9. The Standard requires an entity to apply one general asset recognition principle to all investment property costs at the time they are incurred, including initial costs and subsequent expenditures. Previously, IPSAS 16 contained two recognition principles: one applied to initial costs while another applied to subsequent expenditures (see paragraphs 20-23, 25).

IN10. The Standard requires an entity to measure investment property acquired in an asset exchange transaction at fair value unless the transaction lacks commercial substance, or the fair value of neither the asset given up nor the asset received can be reliably measured. Previously, IPSAS 16 did not contain requirements with regard to the accounting treatment for asset exchange transactions (see paragraphs 36-38).

IN11. the Standard requires an entity to derecognize the carrying amount of a part of an investment property if that part has been replaced and the cost of replacement has been included in the carrying amount of the asset (see paragraph 79). Previously, the derecognition principle contained in IPSAS 16 did not apply to replaced parts. The recognition principle for subsequent expenditures in IPSAS 16 effectively precluded the cost of a replacement from being included in the carrying amount of the asset.

IN12. The Standard requires an entity to include compensation from third parties for an investment property that was impaired, lost or given up in surplus or deficit when the compensation becomes receivable. Previously, IPSAS 16 did not contain this requirement (see paragraphs 83).

**IPSAS 16—INVESTMENT PROPERTY****Objective**

1. The objective of this International Public Sector Accounting Standard is to prescribe the accounting treatment for investment property and related disclosure requirements.

**Scope**

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for investment property.**
3. **This Standard applies to all public sector entities other than Government Business Enterprises.**
4. This Standard applies to accounting for investment property including the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease and to the measurement in a lessor's financial statements of investment property provided to a lessee under an operating lease. This Standard does not deal with matters covered in International Public Sector Accounting Standard IPSAS 13, "Leases," including:
  - (a) Classification of leases as finance leases or operating leases;
  - (b) Recognition of lease revenue from investment property (see also International Public Sector Accounting Standard IPSAS 9, "Revenue from Exchange Transactions");
  - (c) Measurement in a lessee's financial statements of property interests held under a lease accounted for as an operating lease;
  - (d) Measurement in a lessor's financial statements of its net investment in a finance lease;
  - (e) Accounting for sale and leaseback transactions; and
  - (f) Disclosure about finance leases and operating leases.
5. This Standard does not apply to:
  - (a) Biological assets related to agricultural activity (see the relevant international or national accounting standard dealing with agriculture); and
  - (b) Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources.
6. The "Preface to International Public Sector Accounting Standards" issued by the International Public Sector Accounting Standards Board (IPSASB)

explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board. GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”

## Definitions

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

**Carrying amount** is (for the purpose of this Standard) the amount at which an asset is recognized in the statement of financial position.

**Cost** is the amount of cash or cash equivalents paid or the fair value of other consideration given to acquire an asset at the time of its acquisition or construction.

**Exchange transactions** are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

**Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.

**Investment property** is property (land or a building – or part of a building – or both) held to earn rentals or for capital appreciation or both, rather than for:

- (a) Use in the production or supply of goods or services or for administrative purposes; or
- (b) Sale in the ordinary course of operations.

**Non-exchange transactions** are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

**Owner-occupied property** is property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.

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

**Property Interest held by a Lessee under an Operating Lease**

8. **A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model set out in paragraphs 42-64 for the asset recognized. This classification alternative is available on a property-by-property basis. However, once this classification alternative is selected for one such property interest held under an operating lease, all property classified as investment property shall be accounted for using the fair value model. When this classification alternative is selected, any interest so classified is included in the disclosures required by paragraphs 85-89.**

**Investment Property**

9. There are a number of circumstances in which public sector entities may hold property to earn rental and for capital appreciation. For example, a public sector entity (other than a GBE) may be established to manage a government's property portfolio on a commercial basis. In this case, the property held by the entity, other than property held for resale in the ordinary course of operations, meets the definition of an investment property. Other public sector entities may also hold property for rentals or capital appreciation and use the cash generated to finance their other (service delivery) activities. For example, a university or local government may own a building for the purpose of leasing on a commercial basis to external parties to generate funds, rather than to produce or supply goods and services. This property would also meet the definition of investment property.
10. Investment property is held to earn rentals or for capital appreciation or both. Therefore, investment property generates cash flows largely independently of the other assets held by an entity. This distinguishes investment property from other land or buildings controlled by public sector entities, including owner-occupied property. The production or supply of goods or services (or the use of property for administrative purposes) can also generate cash flows. For example, public sector entities may use a building to provide goods and services to recipients in return for full or partial cost recovery. However, the building is held to facilitate the production of goods and services and the cash flows are attributable not only to the building, but also to other assets used in the production or supply process. International Public Sector Accounting Standard IPSAS 17, "Property, Plant and Equipment" applies to owner-occupied property.
11. In some public sector jurisdictions, certain administrative arrangements exist such that an entity may control an asset that may be legally owned by another entity. For example, a government department may control and account for certain buildings that are legally owned by the State. In such circumstances,

references to owner-occupied property means property occupied by the entity that recognizes the property in its financial statements.

12. The following are examples of investment property:
  - (a) Land held for long-term capital appreciation rather than for short-term sale in the ordinary course of operations. For example, land held by a hospital for capital appreciation which may be sold at a beneficial time in the future.
  - (b) Land held for a currently undetermined future use. (If an entity has not determined that it will use the land as owner-occupied property, including occupation to provide services such as those provided by national parks to current and future generations, or for short-term sale in the ordinary course of operations, the land is regarded as held for capital appreciation).
  - (c) A building owned by the entity (or held by the entity under a finance lease) and leased out under one or more operating leases on a commercial basis. For example, a university may own a building that it leases on a commercial basis to external parties.
  - (d) A building that is vacant but is held to be leased out under one or more operating leases on a commercial basis to external parties.
13. The following are examples of items that are not investment property and are therefore outside the scope of this Standard:
  - (a) Property held for sale in the ordinary course of operations or in the process of construction or development for such sale (IPSAS 12, “Inventories”). For example, a municipal government may routinely supplement rate income by buying and selling property, in which case property held exclusively with a view to subsequent disposal in the near future or for development for resale is classified as inventory. A housing department may routinely sell part of its housing stock in the ordinary course of its operations as a result of changing demographics, in which case any housing stock held for sale is classified as inventory.
  - (b) Property being constructed or developed on behalf of third parties. For example, a property and service department may enter into construction contracts with entities external to its government (see IPSAS 11 “Construction Contracts”).
  - (c) Owner-occupied property (see IPSAS 17), including (among other things) property held for future use as owner-occupied property, property held for future development and subsequent use as owner-occupied property, property occupied by employees such as housing for military personnel (whether or not the employees pay rent at market rates) and owner-occupied property awaiting disposal.

- (d) Property that is being constructed or developed for future use as investment property. IPSAS 17 applies to such property until construction or development is complete, at which time the property becomes investment property and this Standard applies. However, this Standard applies to existing investment property that is being redeveloped for continued future use as investment property (see paragraph 68).
  - (e) Property that is leased to another entity under a finance lease.
  - (f) Property held to provide a social service and which also generates cash inflows. For example, a housing department may hold a large housing stock used to provide housing to low income families at below market rental. In this situation, the property is held to provide housing services rather than for rentals or capital appreciation and rental revenue generated is incidental to the purposes for which the property is held. Such property is not considered an “investment property” and would be accounted for in accordance with IPSAS 17.
  - (g) Property held for strategic purposes which would be accounted for in accordance with IPSAS 17.
14. In many jurisdictions, public sector entities will hold property to meet service delivery objectives rather than to earn rental or for capital appreciation. In such situations the property will not meet the definition of investment property. However, where a public sector entity does hold property to earn rental or for capital appreciation, this Standard is applicable. In some cases, public sector entities hold some property that comprises a portion that is held to earn rentals or for capital appreciation rather than to provide services and another portion that is held for use in the production or supply of goods or services or for administrative purposes. For example, a hospital or a university may own a building, part of which is used for administrative purposes, and part of which is leased out as apartments on a commercial basis. If these portions could be sold separately (or leased out separately under a finance lease), an entity accounts for the portions separately. If the portions could not be sold separately, the property is investment property only if an insignificant portion is held for use in the production or supply of goods or services or for administrative purposes.
15. In some cases, an entity provides ancillary services to the occupants of a property it holds. An entity treats such a property as investment property if the services are insignificant to the arrangement as a whole. An example is when a government agency owns an office building which is held exclusively for rental purposes and rented on a commercial basis and also provides security and maintenance services to the lessees who occupy the building.
16. In other cases, the services provided are significant. For example, a government may own a hotel or hostel that it manages through its general

property management agency. The services provided to guests are significant to the arrangement as a whole. Therefore, an owner-managed hotel or hostel is owner-occupied property, rather than investment property.

17. It may be difficult to determine whether ancillary services are so significant that a property does not qualify as investment property. For example, a government or government agency which is the owner of a hotel may transfer some responsibilities to third parties under a management contract. The terms of such management contracts vary widely. At one end of the spectrum, the government's or government agency's position may, in substance, be that of a passive investor. At the other end of the spectrum, the government or government agency may simply have outsourced day-to-day functions while retaining significant exposure to variation in the cash flows generated by the operations of the hotel.
18. Judgment is needed to determine whether a property qualifies as investment property. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of investment property and with the related guidance in paragraphs 9 to 17. Paragraph 86(c) requires an entity to disclose these criteria when classification is difficult.
19. In some cases, an entity owns property that is leased to, and occupied by, its controlling entity or another controlled entity. The property does not qualify as investment property in consolidated financial statements, because the property is owner-occupied from the perspective of the economic entity. However, from the perspective of the entity that owns it, the property is investment property if it meets the definition in paragraph 7. Therefore, the lessor treats the property as investment property in its individual financial statements. This situation may arise where a government establishes a property management entity to manage government office buildings. The buildings are then leased out to other government entities on a commercial basis. In the financial statements of the property management entity, the property would be accounted for as investment property. However, in the consolidated financial statements of the government the property would be accounted for as property, plant and equipment in accordance with IPSAS 17.

### Recognition

20. **Investment property shall be recognized as an asset when, and only when:**
  - (a) **It is probable that the future economic benefits or service potential that are associated with the investment property will flow to the entity; and**
  - (b) **The cost or fair value of the investment property can be measured reliably.**

21. In determining whether an item satisfies the first criterion for recognition, an entity needs to assess the degree of certainty attaching to the flow of future economic benefits or service potential on the basis of the available evidence at the time of initial recognition. Existence of sufficient certainty that the future economic benefits or service potential will flow to the entity necessitates an assurance that the entity will receive the rewards attaching to the asset and will undertake the associated risks. This assurance is usually only available when the risks and rewards have passed to the entity. Before this occurs, the transaction to acquire the asset can usually be cancelled without significant penalty and, therefore, the asset is not recognized.
22. The second criterion for recognition is usually readily satisfied because the exchange transaction evidencing the purchase of the asset identifies its cost. As specified in paragraph 27 of this Standard, under certain circumstances an investment property may be acquired at no cost or for a nominal cost. In such cases, cost is the investment property's fair value as at the date of acquisition.
23. An entity evaluates under this recognition principle all its investment property costs at the time they are incurred. These costs include costs incurred initially to acquire an investment property and costs incurred subsequently to add to, replace part of, or service a property.
24. Under the recognition principle in paragraph 20, an entity does not recognize in the carrying amount of an investment property the costs of the day-to-day servicing of such a property. Rather, these costs are recognized in surplus or deficit as incurred. Costs of day-to-day servicing are primarily the costs of labor and consumables, and may include the cost of minor parts. The purpose of these expenditures is often described as for the repairs and maintenance of the property.
25. Parts of investment property may have been acquired through replacement. For example, the interior walls may be replacements of original walls. Under the recognition principle, an entity recognizes in the carrying amount of an investment property the cost of replacing part of an existing investment property at the time that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognized in accordance with the derecognition provisions of this Standard.

### **Measurement at Recognition**

26. **Investment property shall be measured initially at its cost (transaction costs shall be included in this initial measurement).**
27. **Where an investment property is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.**

28. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure. Directly attributable expenditure includes, for example, professional fees for legal services, property transfer taxes and other transaction costs.
29. The cost of a self-constructed investment property is its cost at the date when the construction or development is complete. Until that date, an entity applies IPSAS 17. At that date, the property becomes investment property and this Standard applies (see paragraphs 66(e) and 76).
30. The cost of investment property is not increased by:
- (a) Start-up costs (unless they are necessary to bring the property to the condition necessary for it to be capable of operating in the manner intended by management);
  - (b) Operating losses incurred before the investment property achieves the planned level of occupancy; or
  - (c) Abnormal amounts of wasted material, labor or other resources incurred in constructing or developing the property.
31. If payment for investment property is deferred, its cost is the cash price equivalent. The difference between this amount and the total payments is recognized as interest expense over the period of credit.
32. An investment property may be acquired through a non-exchange transaction. For example, a national government may transfer at no charge a surplus office building to a local government entity, which then lets it out at market rent. An investment property may also be acquired through a non-exchange transaction by the exercise of powers of sequestration. In these circumstances, the cost of the property is its fair value as at the date it is acquired.
33. Where an entity initially recognizes its investment property at fair value in accordance with paragraph 27, the fair value is the cost of the property. The entity shall decide, subsequent to initial recognition, to adopt either the fair value model (paragraphs 42 to 64) or the cost model (paragraph 65).
34. **The initial cost of a property interest held under a lease and classified as an investment property shall be as prescribed for a finance lease by paragraph 28 of IPSAS 13, i.e., the asset shall be recognized at the lower of the fair value of the property and the present value of the minimum lease payments. An equivalent amount shall be recognized as a liability in accordance with that same paragraph.**
35. Any premium paid for a lease is treated as part of the minimum lease payments for this purpose, and is therefore included in the cost of the asset, but is excluded from the liability. If a property interest held under a lease is classified as investment property, the item accounted for at fair value is that interest and not the underlying property. Guidance on determining the fair

value of a property interest is set out for the fair value model in paragraphs 42-61. That guidance is also relevant to the determination of fair value when that value is used as cost for initial recognition purposes.

36. One or more investment properties may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an investment property is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognize the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.
37. An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows or service potential is expected to change as a result of the transaction. An exchange transaction has commercial substance if:
- (a) The configuration (risk, timing and amount) of the cash flows or service potential of the asset received differs from the configuration of the cash flows or service potential of the asset transferred; or
  - (b) The entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
  - (c) The difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows, if tax applies. The result of these analyses may be clear without an entity having to perform detailed calculations.

38. The fair value of an asset for which comparable market transactions do not exist is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If the entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

## Measurement After Recognition

### Accounting Policy

39. **With the exception noted in paragraph 43, an entity shall choose as its accounting policy either the fair value model in paragraphs 42-64 or the cost model in paragraph 65 and shall apply that policy to all of its investment property.**
40. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” states that a voluntary change in accounting policy shall be made only if the change will result in a more appropriate presentation of transactions, other events or conditions in the entity’s financial statements. It is highly unlikely that a change from the fair value model to the cost model will result in a more appropriate presentation.
41. This Standard requires all entities to determine the fair value of investment property, for the purpose of either measurement (if the entity uses the fair value model) or disclosure (if it uses the cost model). An entity is encouraged, but not required, to determine the fair value of investment property on the basis of a valuation by an independent valuer who holds a recognized and relevant professional qualification and has recent experience in the location and category of the investment property being valued.

### Fair Value Model

42. **After initial recognition, an entity that chooses the fair value model shall measure all of its investment property at fair value, except in the cases described in paragraph 62.**
43. **When a property interest held by a lessee under an operating lease is classified as an investment property under paragraph 8, paragraph 39 is not elective; the fair value model shall be applied.**
44. **A gain or loss arising from a change in the fair value of investment property shall be recognized in surplus or deficit for the period in which it arises.**
45. The fair value of investment property is the price at which the property could be exchanged between knowledgeable, willing parties in an arm’s length transaction (see paragraph 7). Fair value specifically excludes an estimated price inflated or deflated by special terms or circumstances such as atypical financing, sale and leaseback arrangements, special considerations or concessions granted by anyone associated with the sale.
46. An entity determines fair value without any deduction for transaction costs it may incur on sale or other disposal.
47. **The fair value of investment property shall reflect market conditions at the reporting date.**

48. Fair value is time-specific as of a given date. Because market conditions may change, the amount reported as fair value may be incorrect or inappropriate if estimated as of another time. The definition of fair value also assumes simultaneous exchange and completion of the contract for sale without any variation in price that might be made in an arm's length transaction between knowledgeable, willing parties if exchange and completion are not simultaneous.
49. The fair value of investment property reflects, among other things, rental revenue from current leases and reasonable and supportable assumptions that represent what knowledgeable, willing parties would assume about rental revenue from future leases in the light of current conditions. It also reflects, on a similar basis, any cash outflows (including rental payments and other outflows) that could be expected in respect of the property. Some of those outflows are reflected in the liability whereas others relate to outflows that are not recognized in the financial statements until a later date (e.g., periodic payments such as contingent rents).
50. Paragraph 34 specifies the basis for initial recognition of the cost of an interest in a leased property. Paragraph 42 requires the interest in the leased property to be remeasured, if necessary, to fair value. In a lease negotiated at market rates, the fair value of an interest in a leased property at acquisition, net of all expected lease payments (including those relating to recognized liabilities), should be zero. This fair value does not change regardless of whether, for accounting purposes, a leased asset and liability are recognized at fair value or at the present value of minimum lease payments, in accordance with paragraph 28 of IPSAS 13. Thus, remeasuring a leased asset from cost in accordance with paragraph 34 to fair value in accordance with paragraph 42 should not give rise to any initial gain or loss, unless fair value is measured at different times. This could occur when an election to apply the fair value model is made after initial recognition.
51. The definition of fair value refers to "knowledgeable, willing parties." In this context, "knowledgeable" means that both the willing buyer and the willing seller are reasonably informed about the nature and characteristics of the investment property, its actual and potential uses, and market conditions at the reporting date. A willing buyer is motivated, but not compelled, to buy. This buyer is neither over-eager nor determined to buy at any price. The assumed buyer would not pay a higher price than a market comprising knowledgeable, willing buyers and sellers would require.
52. A willing seller is neither an over-eager nor a forced seller, prepared to sell at any price, nor one prepared to hold out for a price not considered reasonable in current market conditions. The willing seller is motivated to sell the investment property at market terms for the best price obtainable. The factual circumstances of the actual investment property owner are not a part of this consideration because the willing seller is a hypothetical owner (e.g., a willing

seller would not take into account the particular tax circumstances of the actual investment property owner).

53. The definition of fair value refers to an arm's length transaction. An arm's length transaction is one between parties that do not have a particular or special relationship that makes prices of transactions uncharacteristic of market conditions. The transaction is presumed to be between unrelated parties, each acting independently.
54. The best evidence of fair value is given by current prices in an active market for similar property in the same location and condition and subject to similar lease and other contracts. An entity takes care to identify any differences in the nature, location or condition of the property, or in the contractual terms of the leases and other contracts relating to the property.
55. In the absence of current prices in an active market of the kind described in paragraph 54, an entity considers information from a variety of sources, including:
  - (a) Current prices in an active market for properties of different nature, condition or location (or subject to different lease or other contracts), adjusted to reflect those differences;
  - (b) Recent prices of similar properties on less active markets, with adjustments to reflect any changes in economic conditions since the date of the transactions that occurred at those prices; and
  - (c) Discounted cash flow projections based on reliable estimates of future cash flows, supported by the terms of any existing lease and other contracts and (when possible) by external evidence such as current market rents for similar properties in the same location and condition, and using discount rates that reflect current market assessments of the uncertainty in the amount and timing of the cash flows.
56. In some cases, the various sources listed in the previous paragraph may suggest different conclusions about the fair value of an investment property. An entity considers the reasons for those differences, in order to arrive at the most reliable estimate of fair value within a range of reasonable fair value estimates.
57. In exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes an investment property following the completion of construction or development, or after a change in use) that the variability in the range of reasonable fair value estimates will be so great, and the probabilities of the various outcomes so difficult to assess, that the usefulness of a single estimate of fair value is negated. This may indicate that the fair value of the property will not be reliably determinable on a continuing basis (see paragraph 62).

58. Fair value differs from value in use, as defined in IPSAS 21, “Impairment of Non-Cash-Generating Assets” and International Accounting Standard IAS 36, “Impairment of Assets.”<sup>1</sup> Fair value reflects the knowledge and estimates of knowledgeable, willing buyers and sellers. In contrast, value in use reflects the entity’s estimates, including the effects of factors that may be specific to the entity and not applicable to entities in general. For example, fair value does not reflect any of the following factors to the extent that they would not be generally available to knowledgeable, willing buyers and sellers:
- (a) Additional value derived from the creation of a portfolio of properties in different locations;
  - (b) Synergies between investment property and other assets;
  - (c) Legal rights or legal restrictions that are specific only to the current owner; and
  - (d) Tax benefits or tax burdens that are specific to the current owner.
59. In determining the fair value of investment property, an entity does not double-count assets or liabilities that are recognized as separate assets or liabilities. For example:
- (a) Equipment such as elevators or air-conditioning is often an integral part of a building and is generally included in the fair value of the investment property, rather than recognized separately as property, plant and equipment.
  - (b) If an office is leased on a furnished basis, the fair value of the office generally includes the fair value of the furniture, because the rental revenue relates to the furnished office. When furniture is included in the fair value of investment property, an entity does not recognize that furniture as a separate asset.
  - (c) The fair value of investment property excludes prepaid or accrued operating lease revenue, because the entity recognizes it as a separate liability or asset.
  - (d) The fair value of investment property held under a lease reflects expected cash flows (including contingent rent that is expected to become payable). Accordingly, if a valuation obtained for a property is net of all payments expected to be made, it will be necessary to add back any recognized lease liability, to arrive at the fair value of the investment property for accounting purposes.

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<sup>1</sup> IPSAS 21 defines value in use of a non-cash-generating asset as “the present value of the asset’s remaining service potential.” IAS 36, “Impairment of Assets,” defines value in use as “the present value of the future cash flows expected to be derived from an asset or cash-generating unit.” The IPSASB is currently developing a Standard on impairment of cash-generating assets based on IAS 36.

60. The fair value of investment property does not reflect future capital expenditure that will improve or enhance the property and does not reflect the related future benefits from this future expenditure.
61. In some cases, an entity expects that the present value of its payments relating to an investment property (other than payments relating to recognized liabilities) will exceed the present value of the related cash receipts. An entity applies IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets" to determine whether to recognize a liability and, if so, how to measure it.

#### **Inability to Determine Fair Value Reliably**

62. **There is a rebuttable presumption that an entity can reliably determine the fair value of an investment property on a continuing basis. However, in exceptional cases, there is clear evidence when an entity first acquires an investment property (or when an existing property first becomes investment property following the completion of construction or development, or after a change in use) that the fair value of the investment property is not reliably determinable on a continuing basis. This arises when, and only when, comparable market transactions are infrequent and alternative reliable estimates of fair value (for example, based on discounted cash flow projections) are not available. In such cases, an entity shall measure that investment property using the cost model in IPSAS 17, "Property, Plant and Equipment." The residual value of the investment property shall be assumed to be zero. The entity shall apply IPSAS 17 until disposal of the investment property.**
63. In the exceptional cases when an entity is compelled, for the reason given in the previous paragraph, to measure an investment property using the cost model in accordance with IPSAS 17, it measures all its other investment property at fair value. In these cases, although an entity may use the cost model for one investment property, the entity shall continue to account for each of the remaining properties using the fair value model.
64. **If an entity has previously measured an investment property at fair value, it shall continue to measure the property at fair value until disposal (or until the property becomes owner-occupied property or the entity begins to develop the property for subsequent sale in the ordinary course of operations) even if comparable market transactions become less frequent or market prices become less readily available.**

#### **Cost Model**

65. **After initial recognition, an entity that chooses the cost model shall measure all of its investment property in accordance with IPSAS 17's requirements for that model, i.e., at cost less any accumulated depreciation and any accumulated impairment losses.**

## Transfers

66. **Transfers to, or from, investment property shall be made when, and only when, there is a change in use, evidenced by:**
- (a) **Commencement of owner-occupation, for a transfer from investment property to owner-occupied property;**
  - (b) **Commencement of development with a view to sale, for a transfer from investment property to inventories;**
  - (c) **End of owner-occupation, for a transfer from owner-occupied property to investment property;**
  - (d) **Commencement of an operating lease (on a commercial basis) to another party, for a transfer from inventories to investment property; or**
  - (e) **End of construction or development, for a transfer from property in the course of construction or development (covered by IPSAS 17) to investment property.**
67. A government's use of property may change over time. For example, a government may decide to occupy a building currently used as an investment property or to convert a building currently used as naval quarters or for administrative purposes into a hotel and to let that building to private sector operators. In the former case, the building would be accounted for as an investment property until commencement of occupation. In the latter case, the building would be accounted for as property, plant and equipment until its occupation ceased and it is reclassified as an investment property.
68. Paragraph 66(b) requires an entity to transfer a property from investment property to inventories when, and only when, there is a change in use, evidenced by commencement of development with a view to sale. When an entity decides to dispose of an investment property without development, it continues to treat the property as an investment property until it is derecognized (eliminated from the statement of financial position) and does not treat it as inventory. Similarly, if an entity begins to redevelop an existing investment property for continued future use as investment property, the property remains an investment property and is not reclassified as owner-occupied property during the redevelopment.
69. A government property department may regularly review its buildings to determine whether they are meeting its requirements, and as part of that process may identify, and hold, certain buildings for sale. In this situation, the building may be considered inventory. However, if the government decided to hold the building for its ability to generate rent revenue and its capital appreciation potential it would be reclassified as an investment property on commencement of any subsequent operating lease.

70. Paragraphs 71-76 apply to recognition and measurement issues that arise when an entity uses the fair value model for investment property. When an entity uses the cost model, transfers between investment property, owner-occupied property and inventories do not change the carrying amount of the property transferred and they do not change the cost of that property for measurement or disclosure purposes.
71. **For a transfer from investment property carried at fair value to owner-occupied property or inventories, the property's cost for subsequent accounting in accordance with IPSAS 17 or IPSAS 12 Inventories shall be its fair value at the date of change in use.**
72. **If an owner-occupied property becomes an investment property that will be carried at fair value, an entity shall apply IPSAS 17 up to the date of change in use. The entity shall treat any difference at that date between the carrying amount of the property in accordance with IPSAS 17 and its fair value in the same way as a revaluation in accordance with IPSAS 17.**
73. Up to the date when an owner-occupied property becomes an investment property carried at fair value, an entity depreciates the property and recognizes any impairment losses that have occurred. The entity treats any difference at that date between the carrying amount of the property in accordance with IPSAS 17 and its fair value in the same way as a revaluation in accordance with IPSAS 17. In other words:
- (a) Any resulting decrease in the carrying amount of the property is recognized in surplus or deficit. However, to the extent that an amount is included in revaluation surplus for that property, the decrease is charged against that revaluation surplus.
  - (b) Any resulting increase in the carrying amount is treated as follows:
    - (i) To the extent that the increase reverses a previous impairment loss for that property, the increase is recognized in surplus or deficit. The amount recognized in surplus or deficit does not exceed the amount needed to restore the carrying amount to the carrying amount that would have been determined (net of depreciation) had no impairment loss been recognized.
    - (ii) Any remaining part of the increase is credited directly to net assets/equity in revaluation surplus. On subsequent disposal of the investment property, the revaluation surplus included in net assets/equity may be transferred to accumulated surpluses or deficits. The transfer from revaluation surplus to accumulated surpluses or deficits is not made through surplus or deficit.
74. **For a transfer from inventories to investment property that will be carried at fair value, any difference between the fair value of the**

**property at that date and its previous carrying amount shall be recognized in surplus or deficit.**

75. The treatment of transfers from inventories to investment property that will be carried at fair value is consistent with the treatment of sales of inventories.
76. **When an entity completes the construction or development of a self-constructed investment property that will be carried at fair value, any difference between the fair value of the property at that date and its previous carrying amount shall be recognized in surplus or deficit.**

### **Disposals**

77. **An investment property shall be derecognized (eliminated from the statement of financial position) on disposal or when the investment property is permanently withdrawn from use and no future economic benefits or service potential are expected from its disposal.**
78. The disposal of an investment property may be achieved by sale or by entering into a finance lease. In determining the date of disposal for investment property, an entity applies the criteria in IPSAS 9 for recognizing revenue from the sale of goods and considers the related guidance in the Appendix to IPSAS 9. IPSAS 13 applies to a disposal effected by entering into a finance lease and to a sale and leaseback.
79. If, in accordance with the recognition principle in paragraph 20, an entity recognizes in the carrying amount of an asset the cost of a replacement for part of an investment property, it derecognizes the carrying amount of the replaced part. For investment property accounted for using the cost model, a replaced part may not be a part that was depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed. Under the fair value model, the fair value of the investment property may already reflect that the part to be replaced has lost its value. In other cases it may be difficult to discern how much fair value should be reduced for the part being replaced. An alternative to reducing fair value for the replaced part, when it is not practical to do so, is to include the cost of the replacement in the carrying amount of the asset and then to reassess the fair value, as would be required for additions not involving replacement.
80. **Gains or losses arising from the retirement or disposal of investment property shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset and shall be recognized in surplus or deficit (unless IPSAS 13, “Leases” requires otherwise on a sale and leaseback) in the period of the retirement or disposal.**

81. The consideration receivable on disposal of an investment property is recognized initially at fair value. In particular, if payment for an investment property is deferred, the consideration received is recognized initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognized as interest revenue in accordance with IPSAS 9 using the effective interest method.
82. An entity applies IPSAS 19 or other Standards, as appropriate, to any liabilities that it retains after disposal of an investment property.
83. **Compensation from third parties for investment property that was impaired, lost or given up shall be recognized in surplus or deficit when the compensation becomes receivable.**
84. Impairments or losses of investment property, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:
- (a) Impairments of investment property are recognized in accordance with IPSAS 21, "Impairment of Non-Cash-Generating Assets." IPSAS 21 requires application of IAS 36, "Impairment of Assets" to cash-generating assets;
  - (b) Retirements or disposals of investment property are recognized in accordance with paragraphs 77-82 of this Standard;
  - (c) Compensation from third parties for investment property that was impaired, lost or given up is recognized in surplus or deficit when it becomes receivable; and
  - (d) The cost of assets restored, purchased or constructed as replacements is determined in accordance with paragraphs 26-38 of this Standard.

## Disclosure

### Fair Value Model and Cost Model

85. The disclosures below apply in addition to those in IPSAS 13. In accordance with IPSAS 13, the owner of an investment property provides lessors' disclosures about leases into which it has entered. An entity that holds an investment property under a finance lease or operating lease provides lessees' disclosures for finance leases and lessors' disclosures for any operating leases into which it has entered.
86. **An entity shall disclose:**
- (a) **Whether it applies the fair value or the cost model.**

- (b) **If it applies the fair value model, whether, and in what circumstances, property interests held under operating leases are classified and accounted for as investment property.**
- (c) **When classification is difficult (see paragraph 18), the criteria it uses to distinguish investment property from owner-occupied property and from property held for sale in the ordinary course of operations.**
- (d) **The methods and significant assumptions applied in determining the fair value of investment property, including a statement whether the determination of fair value was supported by market evidence or was more heavily based on other factors (which the entity shall disclose) because of the nature of the property and lack of comparable market data.**
- (e) **The extent to which the fair value of investment property (as measured or disclosed in the financial statements) is based on a valuation by an independent valuer who holds a recognized and relevant professional qualification and has recent experience in the location and category of the investment property being valued. If there has been no such valuation, that fact shall be disclosed.**
- (f) **The amounts recognized in surplus or deficit for:**
  - (i) **Rental revenue from investment property;**
  - (ii) **Direct operating expenses (including repairs and maintenance) arising from investment property that generated rental revenue during the period; and**
  - (iii) **Direct operating expenses (including repairs and maintenance) arising from investment property that did not generate rental revenue during the period.**
- (g) **The existence and amounts of restrictions on the realizability of investment property or the remittance of revenue and proceeds of disposal.**
- (h) **Contractual obligations to purchase, construct or develop investment property or for repairs, maintenance or enhancements.**

#### **Fair Value Model**

87. **In addition to the disclosures required by paragraph 86, an entity that applies the fair value model in paragraphs 42-64 shall disclose a reconciliation between the carrying amounts of investment property at the beginning and end of the period, showing the following:**

- (a) **Additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognized in the carrying amount of an asset;**
  - (b) **Additions resulting from acquisitions through entity combinations;**
  - (c) **Disposals;**
  - (d) **Net gains or losses from fair value adjustments;**
  - (e) **The net exchange differences arising on the translation of the financial statements into a different presentation currency, and on translation of a foreign operation into the presentation currency of the reporting entity;**
  - (f) **Transfers to and from inventories and owner-occupied property; and**
  - (g) **Other changes.**
88. **When a valuation obtained for investment property is adjusted significantly for the purpose of the financial statements, for example to avoid double-counting of assets or liabilities that are recognized as separate assets and liabilities as described in paragraph 59, the entity shall disclose a reconciliation between the valuation obtained and the adjusted valuation included in the financial statements, showing separately the aggregate amount of any recognized lease obligations that have been added back, and any other significant adjustments.**
89. **In the exceptional cases referred to in paragraph 62, when an entity measures investment property using the cost model in IPSAS 17, the reconciliation required by paragraph 87 shall disclose amounts relating to that investment property separately from amounts relating to other investment property. In addition, an entity shall disclose:**
- (a) **A description of the investment property;**
  - (b) **An explanation of why fair value cannot be determined reliably;**
  - (c) **If possible, the range of estimates within which fair value is highly likely to lie; and**
  - (d) **On disposal of investment property not carried at fair value:**
    - (i) **The fact that the entity has disposed of investment property not carried at fair value;**
    - (ii) **The carrying amount of that investment property at the time of sale; and**
    - (iii) **The amount of gain or loss recognized.**

**Cost Model**

90. **In addition to the disclosures required by paragraph 86, an entity that applies the cost model in paragraph 65 shall disclose:**
- (a) **The depreciation methods used;**
  - (b) **The useful lives or the depreciation rates used;**
  - (c) **The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period;**
  - (d) **A reconciliation of the carrying amount of investment property at the beginning and end of the period, showing the following:**
    - (i) **Additions, disclosing separately those additions resulting from acquisitions and those resulting from subsequent expenditure recognized as an asset;**
    - (ii) **Additions resulting from acquisitions through entity combinations;**
    - (iii) **Disposals;**
    - (iv) **Depreciation;**
    - (v) **The amount of impairment losses recognized, and the amount of impairment losses reversed, during the period in accordance with IPSAS 21;**
    - (vi) **The net exchange differences arising on the translation of the financial statements into a different presentation currency, and on translation of a foreign operation into the presentation currency of the reporting entity;**
    - (vii) **Transfers to and from inventories and owner-occupied property; and**
    - (viii) **Other changes; and**
  - (e) **The fair value of investment property. In the exceptional cases described in paragraph 62, when an entity cannot determine the fair value of the investment property reliably, the entity shall disclose:**
    - (i) **A description of the investment property;**
    - (ii) **An explanation of why fair value cannot be determined reliably; and**
    - (iii) **If possible, the range of estimates within which fair value is highly likely to lie.**

## Transitional Provisions

### Initial Adoption of Accrual Accounting

91. **An entity that adopts accrual accounting for the first time in accordance with International Public Sector Accounting Standards shall initially recognize investment property at cost or fair value. For investment properties that were acquired at no cost, or for a nominal cost, cost is the investment property's fair value as at the date of acquisition.**
92. **The entity shall recognize the effect of the initial recognition of investment property as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which accrual accounting is first adopted in accordance with International Public Sector Accounting Standards.**
93. Prior to first adoption of accrual accounting in accordance with International Public Sector Accounting Standards, an entity may recognize investment property on a basis other than cost or fair value as defined in this Standard, or may control investment property that it has not recognized. This Standard requires entities to initially recognize investment property at cost or, fair value as at the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards. Where assets are initially recognized at cost and were acquired at no cost, or for a nominal cost, cost will be determined by reference to the investment property's fair value as at the date of acquisition. Where the cost of acquisition of an investment property is not known, its cost may be estimated by reference to its fair value as at the date of acquisition.

### Fair Value Model

94. **Under the fair value model, an entity shall recognize the effect of applying this Standard as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the Standard is first applied. In addition:**
  - (a) **If the entity has previously disclosed publicly (in financial statements or otherwise) the fair value of its investment property in earlier periods (determined on a basis that satisfies the definition of fair value in paragraph 7 and the guidance in paragraphs 45-61), the entity is encouraged, but not required:**
    - (i) **To adjust the opening balance of accumulated surpluses or deficits for the earliest period presented for which such fair value was disclosed publicly; and**
    - (ii) **To restate comparative information for those periods; and**

(b) **If the entity has not previously disclosed publicly the information described in (a), it shall not restate comparative information and shall disclose that fact.**

95. On the first application of this Standard an entity may choose to apply the fair value model in respect of investment property already recognized in its financial statements. When this occurs, this Standard requires any adjustment to the carrying amount of the investment property to be taken to the opening balance of accumulated surpluses or deficits for the period in which the Standard is first applied. This Standard requires a treatment different from that required by IPSAS 3. IPSAS 3 requires comparative information to be restated unless such restatement is impracticable. This Standard only encourages such comparative information to be restated in certain circumstances.
96. When an entity first applies this Standard, the adjustment to the opening balance of accumulated surpluses or deficits includes the reclassification of any amount held in revaluation surplus for investment property.
97. An entity that has previously applied IPSAS 16 (2001) and elects for the first time to classify and account for some or all eligible property interests held under operating leases as investment property shall recognize the effect of that election as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the election is first made. In addition, if the entity has previously disclosed publicly (in financial statements or otherwise) the fair value of those property interests in earlier periods, paragraph 94 (a) applies. If the entity has not previously disclosed publicly the information related to those property interests described in paragraph 94 (a), paragraph 94 (b) applies.

#### **Cost Model**

98. Prior to first application of this Standard an entity may recognize its investment property on a basis other than cost, for example fair value or some other measurement basis. IPSAS 3 applies to any change in accounting policies that is made when an entity first applies this Standard and chooses to use the cost model. The effect of the change in accounting policies includes the reclassification of any amount held in revaluation surplus for investment property.
99. IPSAS 3 requires an entity to retrospectively apply accounting policies unless it is impracticable to do so. Therefore, when an entity initially recognizes investment property at cost and chooses to use the cost model in accordance with this Standard, it shall also recognize any accumulated depreciation and any accumulated impairment losses that relate to that property, as if it had always applied those accounting policies.
100. **For entities that have previously applied IPSAS 16 (2001), the requirements of paragraphs 36-38 regarding the initial measurement of**

**an investment property acquired in an exchange of assets transaction shall be applied prospectively only to future transactions.**

### **Effective Date**

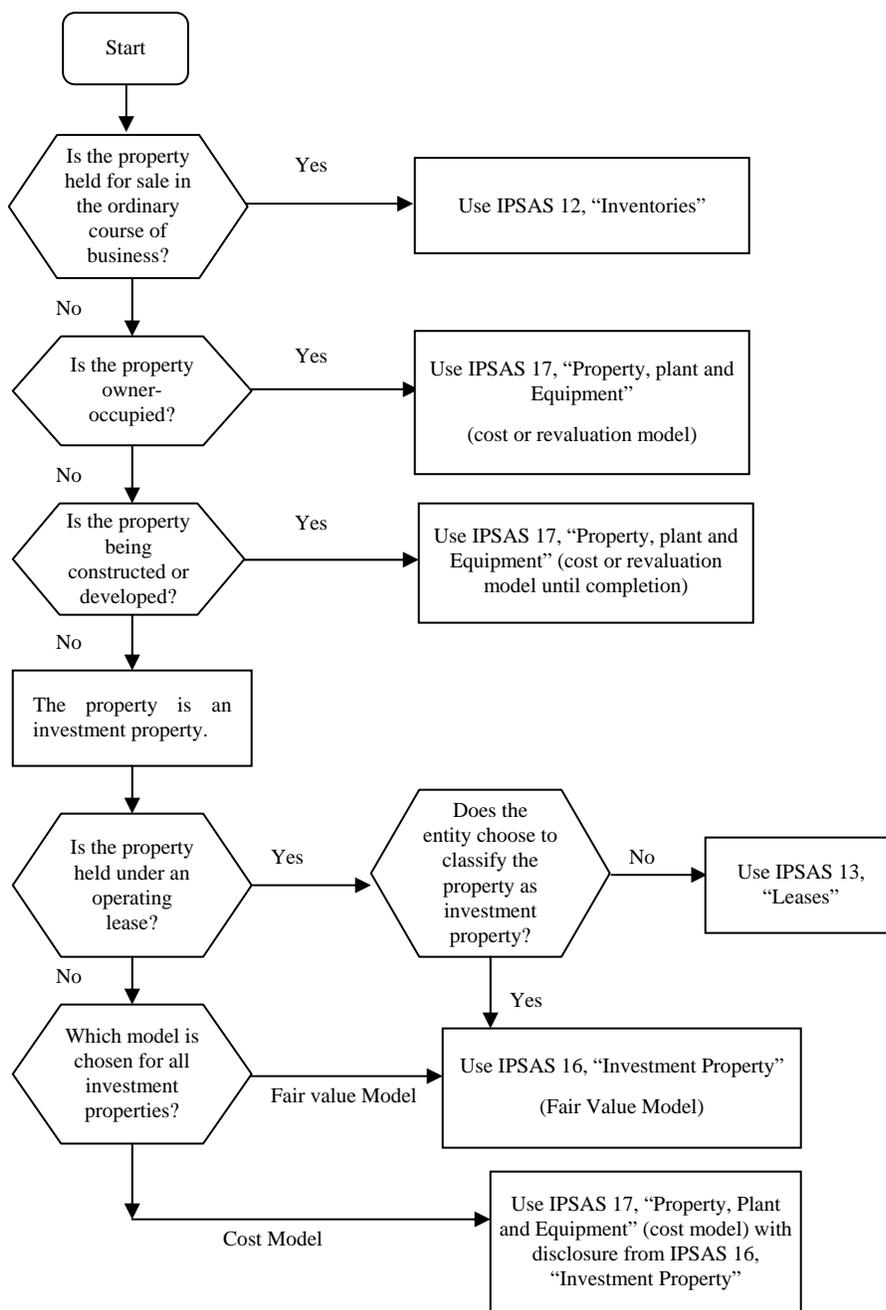
101. **An entity shall apply this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
102. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

### **Withdrawal of IPSAS 16 (2001)**

103. This Standard supersedes IPSAS 16, "Investment Property" issued in 2001.

### Illustrative Decision Tree

The decision tree accompanies, but is not part of, IPSAS 16.



## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the proposed International Public Sector Accounting Standards. This Basis for Conclusions only notes the IPSASB's reasons for departing from the provisions of the related International Accounting Standard.*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)'s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the 'comparison with IFRS' included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 16, issued in December 2001 was based on IAS 40 (2000), "Investment Property" which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 40 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made. (The

<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

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- BC6. IAS 40 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 16 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

### Comparison with IAS 40

IPSAS 16, “Investment Property” is drawn primarily from IAS 40 (2003), “Investment Property.” At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 4, “Insurance Contracts” and IFRS 5, “Non-current Assets Held for Sale and Discontinued Operations,” to public sector entities, therefore IPSAS 16 does not reflect amendments made to IAS 40 consequent upon the issue of those International Financial Reporting Standards. The main differences between IPSAS 16 and IAS 40 are as follows:

- IPSAS 16 requires that investment property initially be measured at cost and specifies that where an asset is acquired for no cost or for a nominal cost, its cost is its fair value as at the date of acquisition. IAS 40 requires investment property to be initially measured at cost.
- There is additional commentary to make clear that IPSAS 16 does not apply to property held to deliver a social service which also generates cash inflows. Such property is accounted for in accordance with IPSAS 17, “Property, Plant and Equipment.”
- IPSAS 16 contains transitional provisions for both the first time adoption and changeover from the previous version of IPSAS 16. IAS 40 only contains transitional provisions for entities that have already used IFRSs. IFRS 1 deals with first time adoption of IFRSs. IPSAS 16 includes additional transitional provisions which specify that when an entity adopts the accrual basis of accounting for the first time and recognizes investment property that was previously unrecognized, the adjustment should be reported in the opening balance of accumulated surpluses or deficits.
- Commentary additional to that in IAS 40 has been included in IPSAS 16 to clarify the applicability of the standards to accounting by public sector entities.
- IPSAS 16 uses different terminology, in certain instances, from IAS 40. The most significant examples are the use of the terms statement of financial performance and statement of financial position in IPSAS 16. The equivalent terms in IAS 40 are income statement and balance sheet.
- IPSAS 16 does not use the term income, which in IAS 40 has a broader meaning than the term revenue.

## **IPSAS 17—PROPERTY, PLANT AND EQUIPMENT**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 16 (revised 2003), “Property, Plant and Equipment” published by the International Accounting Standards Board (IASB). Extracts from IAS 16 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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## IPSAS 17—PROPERTY, PLANT AND EQUIPMENT

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Comparison with IAS 16	

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Equipment” (IPSAS 17) is set out in paragraphs 1-109 and the Appendix. All the paragraphs have equal authority. IPSAS 17 should be read in the context of its objective, the Basis for Conclusion and the Preface to International Public Sector Accounting Standards. IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors” provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

## Introduction

IN1. International Public Sector Accounting Standard (IPSAS) 17, “Property, Plant and Equipment,” replaces 17, “Property, Plant and Equipment” (issued December 2001), and should be applied for annual reporting periods beginning on or after January 1, 2008. Earlier application is encouraged.

## Reasons for Revising IPSAS 17

IN2. The International Public Sector Accounting Standards Board developed this revised IPSAS 17 as a response to the International Accounting Standards Board’s project on Improvement to International Accounting Standards and its own policy to converge public sector accounting standards with private sector standards to the extent appropriate.

IN3. In developing this revised IPSAS 17, the IPSASB adopted the policy of amending the IPSAS for those changes made to the former IAS 16, “Property, Plant and Equipment” made as a consequence of the IASB’s improvements project, except where the original IPSAS had varied from the provisions of IAS 16 for a public sector specific reason; such variances are retained in this IPSAS 16 and are noted in the Comparison with IAS 16. Any changes to IAS 16 made subsequent to the IASB’s improvements project have not been incorporated into IPSAS 16.

## Changes from Previous Requirements

IN4. The main changes from the previous version of IPSAS 17 are described below.

## Definitions

IN5. In paragraph 13:

- The Standard defines the terms carrying amount, impairment loss, impairment loss of a non-cash-generating asset, recoverable amount and recoverable service amount due to the issuance of IPSAS 21, “Impairment of Non-Cash-Generating Assets.” Previously, IPSAS 17 did not define these terms.
- The Standard amends the definition of residual value. The amended definition requires an entity to measure the residual value of an item of property, plant and equipment as the amount it estimates it would receive currently from the disposal of the asset if the asset were already of the age and in the condition expected at the end of its useful life. The previous definition in IPSAS 17 did not clarify that residual value was a current amount.

- The Standard defines the term “entity-specific value,” which refers to “the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.” This term is used where relevant in determining whether an asset exchange transaction has commercial substance. Guidance on how to judge whether an asset exchange transaction has commercial substance is also provided (see paragraphs 38-40). Previously, IPSAS 17 did not contain this definition and the related guidance.

### **Recognition**

- IN6. The Standard requires an entity to apply the general asset recognition principle to all property, plant and equipment costs at the time they are incurred, including initial costs and subsequent expenditures (see paragraphs 14, 19, 22, 24-25). Previously, IPSAS 17 contained two recognition principles—one applied to initial costs while another applied to subsequent expenditures.
- IN7. The Standard clarifies in paragraph 23 that the costs of day-to-day servicing of property, plant and equipment are recognized in surplus or deficit. Previously, IPSAS 17 did not make this very clear.

### **Measurement at Recognition**

- IN8. The Standard requires an entity to include the estimate of asset dismantlement, removal and restoration costs as an element of cost of property, plant and equipment, including the obligations which the entity incurs both when the asset is acquired and when it is used at subsequent periods, except when it is used to produce inventories (see paragraph 30). IPSAS 12 applies to the obligations for dismantling, removing and restoring that are incurred during the period of using the item to produce inventories. Previously, IPSAS 17 included within the cost of property, plant and equipment only the obligation which the entity incurs when the item is acquired.
- IN9. The Standard requires an entity to measure an item of property, plant and equipment acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, at fair value unless: the exchange transaction lacks commercial substance; or the fair value of neither the asset given up nor the asset received can be reliably measured (see paragraphs 38 to 40). Previously, IPSAS 17 divided asset exchange transactions into exchanges between similar assets and exchanges between dissimilar assets. The different categories of exchange were subject to different accounting treatments. For exchange of similar assets, the cost of the asset received was the carrying amount of the asset given up. For exchange of dissimilar assets, the cost was the fair value of the asset given up adjusted by the amount of any cash or cash equivalent transferred.

## **Depreciation**

- IN10. The Standard requires an entity to determine the depreciation charge separately for each significant part of an item of property, plant and equipment (see paragraphs 59 to 63). Previously, IPSAS 17 did not make this clear.
- IN11. The Standard requires an entity to begin depreciating an item of property, plant and equipment when it is available for use and to continue depreciating it until it is derecognized, even if during that period the item is idle (see paragraph 71). Previously, IPSAS 17 did not specify when depreciation of an item began. It specified that an entity should cease depreciating an item when the item was retired from active use and was held for disposal.

## **Compensation for Impairments**

- IN12. The Standard requires an entity to include in surplus or deficit compensation from third parties for an item of property, plant and equipment that was impaired, lost or given up when the compensation becomes receivable (see paragraphs 80). Previously, IPSAS 17 did not include these requirements.

## **Derecognition**

- IN13. The Standard requires an entity to derecognize the carrying amount of an item of property, plant and equipment that it disposes of on the date the criteria for the sale of goods in IPSAS 9, “Revenue from Exchange Transactions” are met (see paragraph 84). Previously, IPSAS 17 did not specify that an entity was to use the criteria contained in IPSAS 9 to determine the date on which it derecognized the carrying amount of a disposed item of property, plant and equipment.
- IN14. The Standard requires an entity to derecognize the carrying amount of a part of an item of property, plant and equipment if that part has been replaced and the entity has included the cost of the replacement in the carrying amount of the item (see paragraph 85). Previously, IPSAS 17 did not apply its derecognition principle to replaced parts. Its recognition principle for subsequent expenditures effectively precluded the cost of a replacement from being included in the carrying amount of the item.

## **Transitional Provisions**

- IN15. The Standard requires the entity to recognize the effects of the initial recognition of property, plant and equipment as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the property, plant and equipment is initially recognized in accordance with IPSAS 17 (see paragraph 97).
- IN16. The Standard clarifies that an entity shall retrospectively apply accounting policies in accordance with IPSAS 3, “Accounting Policies, Changes in

Accounting Estimates and Errors” when it initially recognizes an item of property, plant and equipment at cost in accordance with IPSAS 17 (see paragraph 99).

### **Amendments to Other IPSASs**

IN17. The Standard includes an authoritative appendix of amendments to other IPSASs that are not part of the IPSASs Improvements project and will be impacted as a result of the proposals in this IPSAS.

## IPSAS 17—PROPERTY, PLANT AND EQUIPMENT

### Objective

1. The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment so that users of financial statements can discern information about an entity's investment in its property, plant and equipment and the changes in such investment. The principal issues in accounting for property, plant and equipment are the recognition of the assets, the determination of their carrying amounts and the depreciation charges and impairment losses to be recognized in relation to them.

### Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for property, plant and equipment, except:**
  - (a) **When a different accounting treatment has been adopted in accordance with another International Public Sector Accounting Standard; and**
  - (b) **In respect of heritage assets. However, the disclosure requirements of paragraphs 88, 89 and 92 apply to those heritage assets that are recognized.**
3. **This Standard applies to all public sector entities other than Government Business Enterprises.**
4. This Standard applies to property, plant and equipment including:
  - (a) Specialist military equipment; and
  - (b) Infrastructure assets.

The transitional provisions in paragraphs 95 to 104 provide relief from the requirement to recognize all property, plant and equipment during the five year transitional period.

5. This Standard does not apply to:
  - (a) Biological assets related to agricultural activity (see the relevant international or national accounting standard dealing with agriculture); or
  - (b) Mineral rights and mineral reserves such as oil, natural gas and similar non-regenerative resources (see the relevant international or national accounting standard dealing with mineral rights, mineral reserves and similar non-regenerative resources).

However, this Standard applies to property, plant and equipment used to develop or maintain the assets described in 5(a) or 5(b).

6. Other International Public Sector Accounting Standards may require recognition of an item of property, plant and equipment based on an approach different from that in this Standard. For example, IPSAS 13, “Leases” requires an entity to evaluate its recognition of an item of leased property, plant and equipment on the basis of the transfer of risks and rewards. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.
7. An entity shall apply this Standard to property that is being constructed or developed for future use as investment property but does not yet satisfy the definition of investment property in IPSAS 16, “Investment Property.” Once the construction or development is complete, the property becomes investment property and the entity is required to apply IPSAS 16. IPSAS 16 also applies to investment property that is being redeveloped for continued future use as investment property. An entity using the cost model for investment property in accordance with IPSAS 16 shall use the cost model in this Standard.

### Heritage Assets

8. This Standard does not require an entity to recognize heritage assets that would otherwise meet the definition of, and recognition criteria for, property, plant and equipment. If an entity does recognize heritage assets, it must apply the disclosure requirements of this Standard and may, but is not required to, apply the measurement requirements of this Standard.
9. Some assets are described as heritage assets because of their cultural, environmental or historical significance. Examples of heritage assets include historical buildings and monuments, archaeological sites, conservation areas and nature reserves, and works of art. Certain characteristics, including the following, are often displayed by heritage assets (although these characteristics are not exclusive to such assets):
  - (a) Their value in cultural, environmental, educational and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;
  - (b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
  - (c) They are often irreplaceable and their value may increase over time even if their physical condition deteriorates; and
  - (d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years.

Public sector entities may have large holdings of heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest and sequestration. These assets are rarely held for their

ability to generate cash inflows, and there may be legal or social obstacles to using them for such purposes.

10. Some heritage assets have service potential other than their heritage value, for example, an historic building being used for office accommodation. In these cases, they may be recognized and measured on the same basis as other items of property, plant and equipment. For other heritage assets, their service potential is limited to their heritage characteristics, for example, monuments and ruins. The existence of alternative service potential can affect the choice of measurement base.
11. The disclosure requirements in paragraphs 88 to 94 require entities to make disclosures about recognized assets. Therefore, entities that recognize heritage assets are required to disclose in respect of those assets such matters as, for example:
  - (a) The measurement basis used;
  - (b) The depreciation method used, if any;
  - (c) The gross carrying amount;
  - (d) The accumulated depreciation at the end of the period, if any; and
  - (e) A reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

#### **Government Business Enterprises**

12. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”

#### **Definitions**

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

**Carrying amount (for the purpose of this Standard) is the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.**

**Class of property, plant and equipment means a grouping of assets of a similar nature or function in an entity’s operations that is shown as a single item for the purpose of disclosure in the financial statements.**

**Cost** is the amount of cash or cash equivalents paid and the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

**Depreciation** is the systematic allocation of the depreciable amount of an asset over its useful life.

**Depreciable amount** is the cost of an asset, or other amount substituted for cost, less its residual value.

**Entity-specific value** is the present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.

**Exchange transactions** are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

**Fair value** is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

An **impairment loss** of a cash-generating asset is the amount by which the carrying amount of an asset exceeds its recoverable amount.

An **impairment loss of a non-cash-generating asset** is the amount by which the carrying amount of an asset exceeds its recoverable service amount.

**Non-exchange transactions** are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

**Property, plant and equipment** are tangible items that:

- (a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) Are expected to be used during more than one reporting period.

**Recoverable amount** is the higher of a cash-generating asset's fair value less costs to sell and its value in use.

**Recoverable service amount** is the higher of a non-cash-generating asset's fair value less costs to sell and its value in use.

The **residual value** of an asset is the estimated amount that an entity would currently obtain from disposal of the asset, after deducting the

**estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.**

**Useful life is:**

- (a) **The period over which an asset is expected to be available for use by an entity; or**
- (b) **The number of production or similar units expected to be obtained from the asset by an entity.**

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

## **Recognition**

14. **The cost of an item of property, plant and equipment shall be recognized as an asset if, and only if:**
  - (a) **It is probable that future economic benefits or service potential associated with the item will flow to the entity; and**
  - (b) **The cost or fair value of the item can be measured reliably.**
15. Deleted.
16. Deleted.
17. Spare parts and servicing equipment are usually carried as inventory and recognized in surplus or deficit as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are accounted for as property, plant and equipment.
18. This standard does not prescribe the unit of measure for recognition, i.e., what constitutes an item of property, plant and equipment. Thus, judgment is required in applying the recognition criteria to an entity's specific circumstances. It may be appropriate to aggregate individually insignificant items, such as library books, computer peripherals and small items of equipment, and to apply the criteria to the aggregate value.
19. An entity evaluates under this recognition principle all its property, plant and equipment costs at the time they are incurred. These costs include costs incurred initially to acquire or construct an item of property, plant and equipment and costs incurred subsequently to add to, replace part of, or service it.

20. Specialist military equipment will normally meet the definition of property, plant and equipment and should be recognized as an asset in accordance with this Standard.

#### **Infrastructure Assets**

21. Some assets are commonly described as infrastructure assets. While there is no universally accepted definition of infrastructure assets, these assets usually display some or all of the following characteristics:
- (a) They are part of a system or network;
  - (b) They are specialized in nature and do not have alternative uses;
  - (c) They are immovable; and
  - (d) They may be subject to constraints on disposal.

Although ownership of infrastructure assets is not confined to entities in the public sector, significant infrastructure assets are frequently found in the public sector. Infrastructure assets meet the definition of property, plant and equipment and should be accounted for in accordance with this Standard. Examples of infrastructure assets include road networks, sewer systems, water and power supply systems and communication networks.

#### **Initial Costs**

22. Items of property, plant and equipment may be required for safety or environmental reasons. The acquisition of such property, plant and equipment, although not directly increasing the future economic benefits or service potential of any particular existing item of property, plant and equipment, may be necessary for an entity to obtain the future economic benefits or service potential from its other assets. Such items of property, plant and equipment qualify for recognition as assets because they enable an entity to derive future economic benefits or service potential from related assets in excess of what could be derived had those items not been acquired. For example, fire safety regulations may require a hospital to retro-fit new sprinkler systems. These enhancements are recognized as an asset because without them the entity is unable to operate the hospital in accordance with the regulations. However, the resulting carrying amount of such an asset and related assets is reviewed for impairment in accordance with IPSAS 21, "Impairment of Non-Cash-Generating Assets."

#### **Subsequent Costs**

23. Under the recognition principle in paragraph 14, an entity does not recognize in the carrying amount of an item of property, plant and equipment the costs of the day-to-day servicing of the item. Rather, these costs are recognized in surplus or deficit as incurred. Costs of day-to-day servicing are primarily the costs of labor and consumables, and may include the cost of small parts. The

purpose of these expenditures is often described as for the “repairs and maintenance” of the item of property, plant and equipment.

24. Parts of some items of property, plant and equipment may require replacement at regular intervals. For example, a road may need resurfacing every few years, a furnace may require relining after a specified number of hours of use, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. Items of property, plant and equipment may also be required to make a less frequently recurring replacement, such as replacing the interior walls of a building, or to make a non-recurring replacement. Under the recognition principle in paragraph 14, an entity recognizes in the carrying amount of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the recognition criteria are met. The carrying amount of those parts that are replaced is derecognized in accordance with the derecognition provisions of this Standard (see paragraphs 82 to 87).
25. A condition of continuing to operate an item of property, plant and equipment (for example, an aircraft) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognized in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of previous inspection (as distinct from physical parts) is derecognized. This occurs regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

### **Measurement at Recognition**

26. **An item of property, plant and equipment that qualifies for recognition as an asset shall be measured at its cost.**
27. **Where an asset is acquired through a non-exchange transaction, its cost shall be measured at its fair value as at the date of acquisition.**
28. An item of property, plant and equipment may be acquired through a non-exchange transaction. For example, land may be contributed to a local government by a developer at no or nominal consideration, to enable the local government to develop parks, roads and paths in the development. An asset may also be acquired through a non-exchange transaction by the exercise of powers of sequestration. Under these circumstances the cost of the item is its fair value as at the date it is acquired.
29. For the purposes of this Standard, the measurement at recognition of an item of property, plant and equipment, acquired at no or nominal cost, at its fair value consistent with the requirements of paragraph 27, does not constitute a revaluation. Accordingly, the revaluation requirements in paragraph 44, and

the supporting commentary in paragraphs 45 to 50, only apply where an entity elects to revalue an item of property, plant and equipment in subsequent reporting periods.

### Elements of Cost

30. The cost of an item of property, plant and equipment comprises:
- (a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.
  - (b) Any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management.
  - (c) The initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.
31. Examples of directly attributable costs are:
- (a) Costs of employee benefits (as defined in the relevant international or national accounting standard dealing with employee benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
  - (b) Costs of site preparation;
  - (c) Initial delivery and handling costs;
  - (d) Installation and assembly costs;
  - (e) Costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced while bringing the asset to that location and condition (such as samples produced when testing equipment); and
  - (f) Professional fees.
32. An entity applies IPSAS 12, "Inventories," to the costs of obligations for dismantling, removing and restoring the site on which an item is located that are incurred during a particular period as a consequence of having used the item to produce inventories during that period. The obligations for costs accounted for in accordance with IPSAS 12 and IPSAS 17 are recognized and measured in accordance with IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets."
33. Examples of costs that are not costs of an item of property, plant and equipment are:

- (a) Costs of opening a new facility;
  - (b) Costs of introducing a new product or service (including costs of advertising and promotional activities);
  - (c) Costs of conducting business in a new location or with a new class of customers (including costs of staff training); and
  - (d) Administration and other general overhead costs.
34. Recognition of costs in the carrying amount of an item of property, plant and equipment ceases when the item is in the location and condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an item are not included in the carrying amount of that item. For example, the following costs are not included in the carrying amount of an item of property, plant and equipment:
- (a) Costs incurred while an item capable of operating in the manner intended by management has yet to be brought into use or is operated at less than full capacity;
  - (b) Initial operating losses, such as those incurred while demand for the item's output builds up; and
  - (c) Costs of relocating or reorganizing part or all of the entity's operations.
35. Some operations occur in connection with the construction or development of an item of property, plant and equipment, but are not necessary to bring the item to the location and condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the construction or development activities. For example, revenue may be earned through using a building site as a car park until construction starts. Because incidental operations are not necessary to bring an item to the location and condition necessary for it to be capable of operating in the manner intended by management, the revenue and related expenses of incidental operations are recognized in surplus or deficit, and included in their respective classifications of revenue and expense.
36. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an entity makes similar assets for sale in the normal course of operations, the cost of the asset is usually the same as the cost of constructing an asset for sale (see IPSAS 12, "Inventories"). Therefore, any internal surpluses are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labor, or other resources incurred in self-constructing an asset is not included in the cost of the asset. IPSAS 5, "Borrowing Costs" establishes criteria for the recognition of interest as a component of the carrying amount of a self-constructed item of property, plant and equipment.

**Measurement of cost**

37. The cost of an item of property, plant and equipment is the cash price equivalent or, for an item referred to in paragraph 27, its fair value at the recognition date. If payment is deferred beyond normal credit terms, the difference between the cash price equivalent and the total payment is recognized as interest over the period of credit unless such interest is recognized in the carrying amount of the item in accordance with the allowed alternative treatment in IPSAS 5.
38. One or more items of property, plant and equipment may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an item of property, plant and equipment is measured at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired item is measured in this way even if an entity cannot immediately derecognize the asset given up. If the acquired item is not measured at fair value, its cost is measured at the carrying amount of the asset given up.
39. An entity determines whether an exchange transaction has commercial substance by considering the extent to which its future cash flows or service potential is expected to change as a result of the transaction. An exchange transaction has commercial substance if:
- (a) The configuration (risk, timing and amount) of the cash flows or service potential of the asset received differs from the configuration of the cash flows or service potential of the asset transferred; or
  - (b) The entity-specific value of the portion of the entity's operations affected by the transaction changes as a result of the exchange; and
  - (c) The difference in (a) or (b) is significant relative to the fair value of the assets exchanged.

For the purpose of determining whether an exchange transaction has commercial substance, the entity-specific value of the portion of the entity's operations affected by the transaction shall reflect post-tax cash flows, if tax applies. The result of these analyses may be clear without an entity having to perform detailed calculations.

40. The fair value of an asset for which comparable market transactions do not exist is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that asset or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value. If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset

given up is used to measure the cost of the asset received unless the fair value of the asset received is more clearly evident.

41. The cost of an item of property, plant and equipment held by a lessee under a finance lease is determined in accordance with IPSAS 13, "Leases."

### **Measurement after Recognition**

42. **An entity shall choose either the cost model in paragraph 43 or the revaluation model in paragraph 44 as its accounting policy and shall apply that policy to an entire class of property, plant and equipment.**

#### **Cost Model**

43. **After recognition as an asset, an item of property, plant and equipment shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.**

#### **Revaluation Model**

44. **After recognition as an asset, an item of property, plant and equipment whose fair value can be measured reliably shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated depreciation and subsequent accumulated impairment losses. Revaluations shall be made with sufficient regularity to ensure that the carrying amount does not differ materially from that which would be determined using fair value at the reporting date. The accounting treatment for revaluations is set out in paragraphs 54 to 56.**
45. The fair value of items of property is usually determined from market-based evidence by appraisal. The fair value of items of plant and equipment is usually their market value determined by appraisal. An appraisal of the value of an asset is normally undertaken by a member of the valuation profession, who holds a recognized and relevant professional qualification. For many assets, the fair value will be readily ascertainable by reference to quoted prices in an active and liquid market. For example, current market prices can usually be obtained for land, non-specialized buildings, motor vehicles and many types of plant and equipment.
46. For some public sector assets, it may be difficult to establish their market value because of the absence of market transactions for these assets. Some public sector entities may have significant holdings of such assets.
47. If no evidence is available to determine the market value in an active and liquid market of an item of property, the fair value of the item may be established by reference to other items with similar characteristics, in similar circumstances and location. For example, the fair value of vacant government land that has been held for a long period during which time there have been few transactions may be estimated by reference to the market value of land

with similar features and topography in a similar location for which market evidence is available. In the case of specialized buildings and other man-made structures, fair value may be estimated using depreciated replacement cost, or the restoration cost or service units approaches (see IPSAS 21). In many cases, the depreciated replacement cost of an asset can be established by reference to the buying price of a similar asset with similar remaining service potential in an active and liquid market. In some cases, an asset's reproduction cost will be the best indicator of its replacement cost. For example, in the event of loss, a parliament building may be reproduced rather than replaced with alternative accommodation because of its significance to the community.

48. If there is no market-based evidence of fair value because of the specialized nature of the item of plant and equipment, an entity may need to estimate fair value using, for example, reproduction cost, depreciated replacement cost, or the restoration cost or service units approaches (see IPSAS 21). The depreciated replacement cost of an item of plant or equipment may be established by reference to the market buying price of components used to produce the asset or the indexed price for the same or a similar asset based on a price for a previous period. When the indexed price method is used, judgment is required to determine whether production technology has changed significantly over the period, and whether the capacity of the reference asset is the same as that of the asset being valued.
49. The frequency of revaluations depends upon the changes in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some items of property, plant and equipment experience significant and volatile changes in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant changes in fair value. Instead, it may be necessary to revalue the item only every three or five years.
50. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is treated in one of the following ways:
  - (a) Restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to its depreciated replacement cost.
  - (b) Eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. This method is often used for buildings.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount that is accounted for in accordance with paragraphs 54 and 55.

51. **If an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs shall be revalued.**
52. A class of property, plant and equipment is a grouping of assets of a similar nature or function in an entity's operations. The following are examples of separate classes:
  - (a) Land;
  - (b) Operational buildings;
  - (c) Roads;
  - (d) Machinery;
  - (e) Electricity transmission networks;
  - (f) Ships;
  - (g) Aircraft;
  - (h) Specialist military equipment;
  - (i) Motor vehicles;
  - (j) Furniture and fixtures;
  - (k) Office equipment; and
  - (l) Oil rigs.
53. The items within a class of property, plant and equipment are revalued simultaneously in order to avoid selective revaluation of assets and the reporting of amounts in the financial statements that are a mixture of costs and values as at different dates. However, a class of assets may be revalued on a rolling basis provided revaluation of the class of assets is completed within a short period and provided the revaluations are kept up to date.
54. **If the carrying amount of a class of assets is increased as a result of a revaluation, the increase shall be credited directly to revaluation surplus. However, the increase shall be recognized in surplus or deficit to the extent that it reverses a revaluation decrease of the same class of assets previously recognized in surplus or deficit.**
55. **If the carrying amount of a class of assets is decreased as a result of a revaluation, the decrease shall be recognized in surplus or deficit. However, the decrease shall be debited directly to revaluation surplus to**

**the extent of any credit balance existing in the revaluation surplus in respect of that class of assets.**

56. **Revaluation increases and decreases relating to individual assets within a class of property, plant and equipment must be offset against one another within that class but must not be offset in respect of assets in different classes.**
57. Some or all of the revaluation surplus included in net assets/equity in respect of property, plant and equipment may be transferred directly to accumulated surpluses or deficits when the assets are derecognized. This may involve transferring some or the whole of the surplus when the assets within the class of property, plant and equipment to which the surplus relates are retired or disposed of. However, some of the surplus may be transferred as the assets are used by the entity. In such a case, the amount of the surplus transferred would be the difference between depreciation based on the revalued carrying amount of the assets and depreciation based on the assets' original cost. Transfers from revaluation surplus to accumulated surpluses or deficits are not made through surplus or deficit.
58. Guidance on the effects on taxes on surpluses, if any, resulting from the revaluation of property, plant and equipment can be found in the relevant international or national accounting standard dealing with income taxes.

#### **Depreciation**

59. **Each part of an item of property, plant and equipment with a cost that is significant in relation to the total cost of the item shall be depreciated separately.**
60. An entity allocates the amount initially recognized in respect of an item of property, plant and equipment to its significant parts and depreciates separately each such part. For example, in most cases, it would be required to depreciate separately the pavements, formation, curbs and channels, footpaths, bridges and lighting within a road system. Similarly, it may be appropriate to depreciate separately the airframe and engines of an aircraft, whether owned or subject to a finance lease.
61. A significant part of an item of property, plant and equipment may have a useful life and a depreciation method that are the same as the useful life and the depreciation method of another significant part of that same item. Such parts may be grouped in determining the depreciation charge.
62. To the extent that an entity depreciates separately some parts of an item of property, plant and equipment, it also depreciates separately the remainder of the item. The remainder consists of the parts of the item that are individually not significant. If an entity has varying expectations for these parts, approximation

techniques may be necessary to depreciate the remainder in a manner that faithfully represents the consumption pattern and/or useful life of its parts.

63. An entity may choose to depreciate separately the parts of an item that do not have a cost that is significant in relation to the total cost of the item.
64. **The depreciation charge for each period shall be recognized in surplus or deficit unless it is included in the carrying amount of another asset.**
65. The depreciation charge for a period is usually recognized in surplus or deficit. However, sometimes, the future economic benefits or service potential embodied in an asset is absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see IPSAS 12). Similarly, depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognized in accordance with the relevant international or national accounting standard dealing with intangible assets.

#### **Depreciation Amount and Depreciation Period**

66. **The depreciable amount of an asset shall be allocated on a systematic basis over its useful life.**
67. **The residual value and the useful life of an asset shall be reviewed at least at each annual reporting date and, if expectations differ from previous estimates, the change(s) shall be accounted for as a change in an accounting estimate in accordance with IPSAS 3, “Accounting Policies, Changes in Accounting Estimates and Errors.”**
68. Depreciation is recognized even if the fair value of the assets exceeds its carrying amount, as long as the asset’s residual value does not exceed its carrying amount. Repair and maintenance of an asset does not negate the need to depreciate it. Conversely, some assets may be poorly maintained or maintenance may be deferred indefinitely because of budgetary constraints. Where asset management policies exacerbate the wear and tear of an asset, its useful life should be reassessed and adjusted accordingly.
69. The depreciable amount of an asset is determined after deducting its residual value. In practice, the residual value of an asset is often insignificant and therefore immaterial in the calculation of the depreciable amount.
70. The residual value of an asset may increase to an amount equal to or greater than the asset’s carrying amount. If it does, the asset’s depreciation charge is zero unless and until its residual value subsequently decreases to an amount below the asset’s carrying amount.

71. Depreciation of an asset begins when it is available for use i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases when the asset is derecognized. Therefore, depreciation does not cease when the asset becomes idle or is retired from active use and held for disposal unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.
72. The future economic benefits or service potential embodied in an item of property, plant and equipment are consumed by the entity principally through the use of the asset. However, other factors such as technical or commercial obsolescence and wear and tear while an asset remains idle often result in the diminution of the economic benefits or service potential that might have been obtained from the asset. Consequently, all the following factors are considered in determining the useful life of an asset:
- (a) Expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.
  - (b) Expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance program, and the care and maintenance of the asset while idle.
  - (c) Technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.
  - (d) Legal or similar limits on the use of the asset, such as the expiry dates of related leases.
73. The useful life of an asset is defined in terms of the asset's expected utility to the entity. The asset management policy of an entity may involve the disposal of assets after a specified time or after consumption of a specified proportion of the future economic benefits or service potential embodied in the asset. Therefore, the useful life of an asset may be shorter than its economic life. The estimation of the useful life of the asset is a matter of judgment based on the experience of the entity with similar assets.
74. Land and buildings are separable assets and are accounted for separately, even when they are acquired together. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated. Buildings have a limited useful life and therefore are depreciable assets. An increase in the value of the land on which a building stands does not affect the determination of the depreciable amount of the building.
75. If the cost of land includes the cost of site dismantlement, removal and restoration, that portion of the land asset is depreciated over the period of benefits or service potential obtained by incurring those costs. In some cases,

the land itself may have a limited useful life, in which case it is depreciated in a manner that reflects the benefits or service potential to be derived from it.

#### **Depreciation Method**

76. **The depreciation method shall reflect the pattern in which the asset's future economic benefits or service potential is expected to be consumed by the entity.**
77. **The depreciation method applied to an asset shall be reviewed at least at each annual reporting date and, if there has been a significant change in the expected pattern of the consumption of the future economic benefits or service potential embodied in the asset, the method shall be changed to reflect the changed pattern. Such a change shall be accounted for as a change in an accounting estimate in accordance with IPSAS 3.**
78. A variety of depreciation methods can be used to allocate the depreciable amount of an asset on a systematic basis over its useful life. These methods include the straight-line method, the diminishing balance method and the units of production method. Straight-line depreciation results in a constant charge over the useful life if the asset's residual value does not change. The diminishing balance method results in a decreasing charge over the useful life. The units of production method results in a charge based on the expected use or output. The entity selects the method that most closely reflects the expected pattern of consumption of the future economic benefits or service potential embodied in the asset. That method is applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits or service potential.

#### **Impairment**

79. To determine whether an item of property, plant and equipment is impaired, an entity applies IPSAS 21, "Impairment of Non-Cash-Generating Assets". That Standard explains how an entity reviews the carrying amount of its assets, how it determines the recoverable service amount or recoverable amount of an asset, and when it recognizes, or reverses the recognition of, an impairment loss.

#### **Compensation for impairment**

80. **Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall be included in surplus or deficit when the compensation becomes receivable.**
81. Impairments or losses of items of property, plant and equipment, related claims for or payments of compensation from third parties and any subsequent purchase or construction of replacement assets are separate economic events and are accounted for separately as follows:

- (a) Impairments of items of property, plant and equipment are recognized in accordance with IPSAS 21;
- (b) Derecognition of items of property, plant and equipment retired or disposed of is determined in accordance with this Standard;
- (c) Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining surplus or deficit when it becomes receivable; and
- (d) The cost of items of property, plant and equipment restored, purchased or constructed as replacement is determined in accordance with this Standard.

### **Derecognition**

82. **The carrying amount of an item of property, plant and equipment shall be derecognized:**
- (a) **On disposal; or**
  - (b) **When no future economic benefits or service potential is expected from its use or disposal.**
83. **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be included in surplus or deficit when the item is derecognized (unless IPSAS 13, “Leases” requires otherwise on a sale and leaseback). Gains shall not be classified as revenue.**
84. The disposal of an item of property, plant and equipment may occur in a variety of ways (e.g., by sale, by entering into a finance lease or by donation). In determining the date of disposal of an item, an entity applies the criteria in IPSAS 9, “Revenue from Exchange Transactions” for recognizing revenue from the sale of goods. IPSAS 13, “Leases” applies to disposal by a sale and leaseback.
85. If, under the recognition principle in paragraph 14, an entity recognizes in the carrying amount of an item of property, plant and equipment the cost of a replacement for part of the item, then it derecognizes the carrying amount of the replaced part regardless of whether the replaced part had been depreciated separately. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or constructed.
86. **The gain or loss arising from the derecognition of an item of property, plant and equipment shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the item.**
87. The consideration receivable on disposal of an item of property, plant and equipment is recognized initially at its fair value. If payment for the item is

deferred, the consideration received is recognized initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognized as interest revenue in accordance with IPSAS 9 reflecting the effective yield on the receivable.

### **Disclosure**

88. **The financial statements shall disclose, for each class of property, plant and equipment recognized in the financial statements:**
- (a) **The measurement bases used for determining the gross carrying amount;**
  - (b) **The depreciation methods used;**
  - (c) **The useful lives or the depreciation rates used;**
  - (d) **The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and**
  - (e) **A reconciliation of the carrying amount at the beginning and end of the period showing:**
    - (i) **Additions;**
    - (ii) **Disposals;**
    - (iii) **Acquisitions through entity combinations;**
    - (iv) **Increases or decreases resulting from revaluations under paragraphs 44, 54 and 55 and from impairment losses (if any) recognized or reversed directly in net assets/equity in accordance with IPSAS 21;**
    - (v) **Impairment losses recognized in surplus or deficit in accordance with IPSAS 21;**
    - (vi) **Impairment losses reversed in surplus or deficit in accordance with IPSAS 21;**
    - (vii) **Depreciation;**
    - (viii) **The net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity; and**
    - (ix) **Other changes.**
89. **The financial statements shall also disclose for each class of property, plant and equipment recognized in the financial statements:**

- (a) **The existence and amounts of restrictions on title, and property, plant and equipment pledged as securities for liabilities;**
  - (b) **The amount of expenditures recognized in the carrying amount of an item of property, plant and equipment in the course of its construction;**
  - (c) **The amount of contractual commitments for the acquisition of property, plant and equipment; and**
  - (d) **If it is not disclosed separately on the face of the statement of financial performance, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is included in surplus or deficit.**
90. Selection of the depreciation method and the estimation of the useful life of the assets are matters of judgment. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information that allows them to review the policies selected by management and enables comparisons to be made with other entities. For similar reasons, it is necessary to disclose:
- (a) Depreciation, whether recognized in surplus or deficit or as a part of the cost of other assets, during a period; and
  - (b) Accumulated depreciation at the end of the period.
91. In accordance with IPSAS 3, an entity discloses the nature and effect of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods. For property, plant and equipment, such disclosure may arise from changes in estimates with respect to:
- (a) Residual values;
  - (b) The estimated costs of dismantling, removing or restoring items of property, plant and equipment;
  - (c) Useful lives; and
  - (d) Depreciation methods.
92. **If a class of property, plant and equipment is stated at revalued amounts, the following shall be disclosed:**
- (a) **The effective date of the revaluation;**
  - (b) **Whether an independent valuer was involved;**
  - (c) **The methods and significant assumptions applied in estimating the assets' fair values;**
  - (d) **The extent to which the assets' fair values were determined directly by reference to observable prices in an active market or**

- recent market transactions on arm's length terms or were estimated using other valuation techniques;
- (e) **The revaluation surplus, indicating the change for the period and any restrictions on the distribution of the balance to shareholders or other equity holders;**
  - (f) **The sum of all revaluation surpluses for individual items of property, plant and equipment within that class; and**
  - (g) **The sum of all revaluation deficits for individual items of property, plant and equipment within that class.**
93. In accordance with IPSAS 21, an entity discloses information on impaired property, plant and equipment in addition to the information required by paragraph 88(e) (iv) to (vi).
94. Users of financial statements may also find the following information relevant to their needs:
- (a) The carrying amount of temporarily idle property, plant and equipment;
  - (b) The gross carrying amount of any fully depreciated property, plant and equipment that is still in use;
  - (c) The carrying amount of property, plant and equipment retired from active use and held for disposal; and
  - (d) When the cost model is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

Therefore, entities are encouraged to disclose these amounts.

### **Transitional Provisions**

95. **Entities are not required to recognize property, plant and equipment for reporting periods beginning on a date within five years following the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards.**
96. **An entity that adopts accrual accounting for the first time in accordance with International Public Sector Accounting Standards shall initially recognize property, plant and equipment at cost or fair value. For items of property, plant and equipment that were acquired at no cost, or for a nominal cost, cost is the item's fair value as at the date of acquisition.**
97. **The entity shall recognize the effect of the initial recognition of property, plant and equipment as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which the property, plant and equipment is initially recognized.**

98. Prior to first application of this Standard, an entity may recognize its property, plant and equipment on a basis other than cost or fair value as defined in this Standard, or may control assets that it has not recognized. This Standard requires entities to initially recognize items of property, plant and equipment at cost or, fair value as at the date of initial recognition in accordance with this Standard. Where assets are initially recognized at cost and were acquired at no cost, or for a nominal cost, cost will be determined by reference to the asset's fair value as at the date of acquisition. Where the cost of acquisition of an asset is not known, its cost may be estimated by reference to its fair value as at the date of acquisition.
99. IPSAS 3 requires an entity to retrospectively apply accounting policies unless it is impracticable to do so. Therefore, when an entity initially recognizes an item of property, plant and equipment at cost in accordance with this Standard, it shall also recognize any accumulated depreciation and any accumulated impairment losses that relate to that item, as if it had always applied those accounting policies.
100. Paragraph 14 of this Standard requires the cost of an item of property, plant and equipment to be recognized as an asset if, and only if:
- (a) It is probable that future economic benefits or service potential associated with the item will flow to the entity; and
  - (b) The cost or fair value of the item can be measured reliably.
101. The transitional provisions in paragraphs 95 and 96 are intended to give relief in situations where an entity is seeking to comply with the provisions of this Standard, in the context of implementing accrual accounting for the first time in accordance with International Public Sector Accounting Standards, with effect from the effective date of this Standard or subsequently. When entities adopt accrual accounting in accordance with International Public Sector Accounting Standards for the first time, there are often difficulties in compiling comprehensive information on the existence and valuation of assets. For this reason, for a five-year period following the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards, entities are not required to comply fully with the requirements of paragraph 14.
102. Notwithstanding the transitional provisions in paragraph 95 and 96, entities that are in the process of adopting accrual accounting are encouraged to comply in full with the provisions of this Standard as soon as possible.
103. The exemption from the requirements of paragraph 14 implies that the associated measurement and disclosure provisions of this Standard do not need to be complied with in respect of those assets or classes of asset that are not recognized under paragraphs 95 and 96.

104. **When an entity takes advantage of the transitional provisions in paragraphs 95 and 96 that fact shall be disclosed. Information on the major classes of asset that have not been recognized by virtue of paragraph 95 shall also be disclosed. When an entity takes advantage of the transitional provisions for a second or subsequent reporting period, details of the assets or classes of asset that were not recognized at the previous reporting date but that are now recognized shall be disclosed.**
105. **For entities that have previously applied IPSAS 17 (2001), the requirements of paragraphs 38–40 regarding the initial measurement of an item of property, plant and equipment acquired in an exchange of assets transaction shall be applied prospectively only to future transactions.**
106. Transitional provisions in IPSAS 17 (2001) provide entities with a period of up to five years to recognize all property, plant and equipment and make the associated measurement and disclosure from the date of its first application. Entities that have previously applied IPSAS 17 (2001) may continue to take advantage of this five-year transitional period from the date of first application of IPSAS 17 (2001). These entities shall also continue to make disclosures required by paragraph 104.

### **Effective Date**

107. **An entity shall apply this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008, it shall disclose that fact.**
108. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

### **Withdrawal of IPSAS 17 (2001)**

109. This Standard supersedes IPSAS 17, "Property, Plant and Equipment" issued in 2001.

**Appendix****Amendments to Other IPSASs**

*The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after January 1, 2008. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.*

- A1. In IPSAS 18, “Segment Reporting,” paragraph 37 is amended to read as follows:
37. ...Measurements of segment assets and liabilities include any adjustments to the prior carrying amounts of the identifiable segment assets and segment liabilities of an entity acquired in an entity combination accounted for as a purchase, even if those adjustments are made only for the purpose of preparing consolidated financial statements and are not recorded in either the controlling entity’s separate or the controlled entity’s individual financial statements. Similarly, if property, plant, and equipment has been revalued subsequent to acquisition in accordance with the revaluation model in International Public Sector Accounting Standard IPSAS 17, “Property, Plant and Equipment,” measurements of segment assets reflect those revaluations.

## Implementation Guidance 1—Frequency of Revaluation of Property, Plant and Equipment

*This guidance accompanies, but is not part of, IPSAS 17.*

- IG1. Paragraph 44 of IPSAS 17 requires entities that adopt the revaluation model to measure its assets at a revaluated amount does not differ significantly from that which would be determined using fair value at the reporting date. Paragraph 49 of IPSAS 17 specifies that the frequency of revaluations depends upon the changes in the fair values of the items of property, plant and equipment being revalued. When the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. The purpose of this guidance is to assist entities that adopt the revaluation model to determine whether carrying amounts differ materially from the fair value as at reporting date.
- IG2. An entity assesses at each reporting date whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. If any such indication exists, the entity determines the asset's fair value and revalues the asset to that amount.
- IG3. In assessing whether there is any indication that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date, an entity considers, as a minimum, the following indications:

*External sources of information*

- (a) Significant changes affecting the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated;
- (b) Where market exists for the assets of the entity, market values are different from their carrying amounts;
- (c) During the period, a price index relevant to the asset has undergone a material change;

*Internal sources of information*

- (d) Evidence is available of obsolescence or physical damage of an asset;
- (e) Significant changes affecting the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. Adverse changes include the asset becoming idle, or plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite. Favourable changes

include capital expenditure incurred during the period to improve or enhance an asset in excess of its standard of performance assessed immediately before the expenditure is made; and

- (f) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse or better than expected.

IG4. The list in paragraph IG3 is not exhaustive. An entity may identify other indications that a revalued asset's carrying amount may differ materially from that which would be determined if the asset were revalued at the reporting date. The existence of these additional indicators would also indicate that the entity should revalue the asset to its current fair value as at the reporting date.

## Implementation Guidance 2—Illustrative Disclosures Examples

*This guidance accompanies, but is not part of, IPSAS 17.*

The Department of the Interior is a public sector entity that controls a wide range of property, plant and equipment and is responsible for replacement and maintenance of the property. The following are extracts from the notes to its Statement of Financial Position for the year ended 31 December 20X1 and illustrate the principal disclosures required in accordance with this Standard.

### Notes

#### 1. Land

(a) Land consists of twenty thousand hectares at various locations. Land is valued at fair value as at 31 December 20X1, as determined by the Office of the National Valuer, an independent valuer.

(b) Restrictions on Titles:

Five hundred hectares of land (carried at 62,500 currency units) is designated as national interest land and may not be sold without the approval of the legislature. Two hundred hectares (carried at 25,000 currency units) of the national interest land and a further two thousand hectares (carried at 250,000 currency units) of other land are subject to title claims by former owners in an international court of human rights and the Court has ordered that the land may not be disposed of until the claim is decided; the Department recognizes the jurisdiction of the Court to hear these cases.

#### 2. Buildings

(a) Buildings consist of office buildings and industrial facilities at various locations.

(b) Buildings are initially recognized at cost, but are subject to revaluation to fair value on an ongoing basis. The Office of the National Valuer determines fair value on a rolling basis within a short period of time. Revaluations are kept up to date.

(c) Depreciation is calculated on a straight-line basis over the useful life of the building. Office buildings have a useful life of twenty-five years, and industrial facilities have a useful life of fifteen years.

(d) The Department has entered into five contracts for the construction of new buildings; total contract costs are 250,000 currency units.

#### 3. Machinery

(a) Machinery is measured at cost less depreciation.

(b) Depreciation is calculated on a straight-line basis over the useful life of the machine.

- (c) The machinery has various useful lives:
  - Tractors: 10 years
  - Washing Equipment: 4 years
  - Cranes: 15 years
- (d) The Department has entered into a contract to replace the cranes it uses to clean and maintain the buildings - the contracted cost is 100,000 currency units.

4. **Furniture and Fixtures**

- (a) Furniture and fixtures are measured at cost less depreciation.
- (b) Depreciation is calculated on a straight-line basis over the useful life of the furniture and fixtures.
- (c) All items within this class have a useful life of five years.

PROPERTY, PLANT AND EQUIPMENT

**Reconciliations**  
(in '000 of currency units)

Reporting Period	Land		Buildings		Machinery		Furniture and Fixtures	
	20X1	20X0	20X1	20X0	20X1	20X0	20X1	20X0
Opening Balance	2,250	2,025	2,090	2,260	1,085	1,100	200	150
Additions	-	-	250	100	120	200	20	100
Disposals	-	-	150	40	60	80	20	-
Depreciation (As per Statement of Financial Performance)	-	-	160	180	145	135	50	50
Revaluations (net)	250	225	- 30	- 50	-	-	-	-
Closing Balance (As per Statement of Financial Position)	2,500	2,250	2,000	2,090	1,000	1,085	150	200
Sum of Revaluation Surpluses (Paragraph 92(f))	750	500	250	250	-	-	-	-
Sum of Revaluation Deficits (Paragraph 92(g))	25	25	380	350	-	-	-	-
Gross Carrying Amount	2,500	2,250	2,500	2,430	1,500	1,440	250	250
Accumulated Depreciation	-	-	500	340	500	355	100	50
Net Carrying Amount	2,500	2,250	2,000	2,090	1,000	1,085	150	200

## Basis for Conclusions

*This Basis for Conclusions accompanies, but is not part of, the proposed International Public Sector Accounting Standards. This Basis for Conclusions only notes the IPSASB's reasons for departing from the provisions of the related International Accounting Standard.*

### Background

- BC1. The International Public Sector Accounting Standards Board (IPSASB)'s International Financial Reporting Standards (IFRSs) Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge the accrual basis International Public Sector Accounting Standards (IPSASs) with IFRSs issued by the International Accounting Standards Board (IASB) where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the 'comparison with IFRS' included in each IPSAS.
- BC3. In May 2002, the IASB issued an exposure draft of proposed amendments to 13 International Accounting Standards (IASs)<sup>1</sup> as part of its General Improvements Project. The objectives of the IASB's General Improvements project were "to reduce or eliminate alternatives, redundancies and conflicts within the Standards, to deal with some convergence issues and to make other improvements." The final IASs were issued in December 2003.
- BC4. IPSAS 17, issued in December 2001 was based on IAS 16 (Revised 1998), "Investment Property" which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC)<sup>2</sup>, actioned an IPSAS Improvements Project to converge where appropriate IPSASs with the improved IASs issued in December 2003.
- BC5. The IPSASB reviewed the improved IAS 16 and generally concurred with the IASB's reasons for revising the IAS and with the amendments made with the

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<sup>1</sup> The International Accounting Standards (IASs) were issued by the IASB's predecessor, the International Accounting Standards Committee. The Standards issued by the IASB are entitled International Financial Reporting Standards (IFRSs). The IASB has defined IFRSs to consist of IFRSs, IASs and Interpretations of the Standards. In some cases, the IASB has amended, rather than replaced, the IASs, in which case the old IAS number remains.

<sup>2</sup> The PSC became the IPSASB when the IFAC Board changed the PSC's mandate to become an independent standard-setting board in November 2004.

exception noted in paragraph BC 6. (The IASB's Bases for Conclusions are not reproduced here. Subscribers to the IASB's *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at [www.iasb.org](http://www.iasb.org)).

- BC6. IAS 16, "Property, Plant and Equipment" defines recoverable amount as "the higher of an asset's net selling price and its value in use." The proposed IPSAS 17 defines recoverable amount as "the higher of a cash-generating asset's fair value less costs to sell and its value in use." The definition in proposed IPSAS 17 is the same as in IAS 36, "Impairment of Assets" but not IAS 16. The IPSASB is of the view that the definition in IPSAS 17 is appropriate because:
- (a) IPSAS 17 requires an entity to determine the recoverable amount or recoverable service amount in accordance with IPSAS 21, "Impairment of Non-Cash-Generating Assets."
  - (b) IPSAS 21 requires an entity to apply IAS 36 in determining the recoverable amount of cash-generating assets.
- BC7. IAS 16 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 17 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

### Comparison with IAS 16

IPSAS 17, “Property, Plant and Equipment” is drawn primarily from IAS 16 (2003), “Property, Plant and Equipment.” At the time of issuing this Standard, the IPSASB has not considered the applicability of IFRS 5, to public sector entities; therefore IPSAS 17 does not reflect amendments made to IAS 16 consequent upon the issue of International Financial Reporting Standard IFRS 5. The main differences between IPSAS 17 and IAS 16 (2003) are as follows:

- IPSAS 17 does not require or prohibit the recognition of heritage assets. An entity which recognizes heritage assets is required to comply with the disclosure requirements of this Standard with respect to those heritage assets that have been recognized and may, but is not required to, comply with other requirements of this Standard in respect of those heritage assets. IAS 16 does not have a similar exclusion.
- IAS 16 requires items of property, plant and equipment to be initially measured at cost. IPSAS 17 states that where an item is acquired at no cost, or for a nominal cost, its cost is its fair value as at the date it is acquired. IAS 16 requires, where an enterprise adopts the revaluation model and carries items of property, plant and equipment at revalued amounts, the equivalent historical cost amounts to be disclosed. This requirement is not included in IPSAS 17.
- Under IAS 16, revaluation increases and decreases may only be matched on an individual item basis. Under IPSAS 17, revaluation increases and decreases are offset on a class of asset basis.
- IPSAS 17 contains transitional provisions for both the first time adoption and changeover from the previous version of IPSAS 17. IAS 16 only contains transitional provisions for entities that have already used IFRSs. Specifically, IPSAS 17 contains transitional provisions allowing entities to not recognize property, plant and equipment for reporting periods beginning on a date within five years following the date of first adoption of accrual accounting in accordance with International Public Sector Accounting Standards. The transitional provisions also allow entities to recognize property, plant and equipment at fair value on first adopting this Standard. IAS 16 does not include these transitional provisions.
- IPSAS 17 contains definitions of impairment loss of a non-cash-generating asset and recoverable service amount. IAS 16 does not contain these definitions. Commentary additional to that in IAS 16 has been included in IPSAS 17 to clarify the applicability of the standards to accounting by public sector entities.

- IPSAS 17 uses different terminology, in certain instances, from IAS 16. The most significant examples are the use of the terms statement of financial performance, statement of financial position and net assets/equity in IPSAS 17. The equivalent terms in IAS 16 are income statement, balance sheet and equity.
- IPSAS 17 does not use the term income, which in IAS 16 has a broader meaning than the term revenue.
- IPSAS 17 contains Implementation Guidance on the frequency of revaluation of property, plant and equipment. IAS 16 does not contain similar guidance.

**IPSAS 18—SEGMENT REPORTING****Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard IAS 14 (Revised 1997), “Segment Reporting” published by the International Accounting Board (IASB). Extracts from IAS 14 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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*The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.*

## Objective

The objective of this Standard is to establish principles for reporting financial information by segments. The disclosure of this information will:

- (a) Help users of the financial statements to better understand the entity’s past performance and to identify the resources allocated to support the major activities of the entity; and
- (b) Enhance the transparency of financial reporting and enable the entity to better discharge its accountability obligations.

## Scope

1. **An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in the presentation of segment information.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”
4. **This Standard should be applied in complete sets of published financial statements that comply with International Public Sector Accounting Standards (IPSASs).**
5. A complete set of financial statements includes a statement of financial position, statement of financial performance, cash flow statement, a statement showing changes in net assets/equity, and notes, as provided in IPSAS 1, “Presentation of Financial Statements.”
6. **If both consolidated financial statements of a government or other economic entity and the separate financial statements of the parent entity are presented together, segment information need be presented only on the basis of the consolidated financial statements.**
7. In some jurisdictions, the consolidated financial statements of the government or other economic entity and the separate financial statements of the controlling entity are compiled and presented together in a single

report. Where this occurs, the report which contains the government's or other controlling entity's consolidated financial statements needs to present segment information only for the consolidated financial statements.

## Definitions

### Definitions from Other International Public Sector Accounting Standards

8. The following terms are used in this Standard with the meanings specified in International Public Sector Accounting Standards (IPSAS) 2, "Cash Flow Statements"; IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" and IPSAS 9, "Revenue from Exchange Transactions."

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

**Financing activities** are activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.

**Investing activities** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.

**Operating activities** are the activities of the entity that are not investing or financing activities.

**Revenue** is the gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

Other terms defined in International Public Sector Accounting Standards are also used in this Standard with the same meaning as in those other Standards. A Glossary of Defined Terms has been published separately.

### Definition of a Segment

9. A **segment** is a distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of evaluating the entity's past performance in achieving its objectives and for making decisions about the future allocation of resources.
10. Governments and their agencies control significant public resources and operate to provide a wide variety of goods and services to their constituents in differing geographical regions and in regions with differing socio-economic characteristics. These entities are expected, and in some cases formally required, to use those resources efficiently and effectively to

achieve the entity's objectives. Entity-wide and consolidated financial statements provide an overview of the assets controlled and liabilities incurred by the reporting entity, the cost of services provided and the taxation revenue, budget allocations and cost recoveries generated to fund the provision of those services. However, this aggregate information does not provide information about the specific operational objectives and major activities of the reporting entity and the resources devoted to, and costs of, those objectives and activities.

11. In most cases, the activities of the entity are so broad, and encompass so wide a range of different geographical regions, or regions with different socio-economic characteristics, that it is necessary to report disaggregated financial and non-financial information about particular segments of the entity to provide relevant information for accountability and decision making purposes.

### Reporting by Segments

12. **An entity should identify its separate segments in accordance with the requirements of paragraph 9 of this Standard and should present information about those segments as required by paragraph 51 to 75 of this Standard.**
13. Under this Standard, public sector entities will identify as separate segments each distinguishable activity or group of activities for which financial information should be reported for purposes of evaluating the past performance of the entity in achieving its objectives, and for making decisions about the allocation of resources by the entity. In addition to disclosure of the information required by paragraphs 51 to 75 of this Standard, entities are also encouraged to disclose additional information about reported segments as identified by this Standard or as considered necessary for accountability and decision making purposes.

### Reporting Structures

14. In most cases, the major classifications of activities identified in budget documentation will reflect the segments for which information is reported to the governing body and the most senior manager of the entity. In most cases, the segments reported to the governing body and senior manager will also reflect the segments reported in the financial statements. This is because the governing board and senior manager will require information about segments to enable them to discharge their managerial responsibilities and to evaluate the performance of the entity in achieving its objectives in the past and to make decisions about the allocation of resources by the entity in the future.
15. Determining the activities which should be grouped as separate segments and reported in the financial statements for accountability and decision-

making purposes involves judgment. In making that judgment, preparers of the financial statements will consider such matters as:

- (a) The objective of reporting financial information by segment as identified in paragraph 9 above;
- (b) The expectations of members of the community and their elected or appointed representatives regarding the key activities of the entity;
- (c) The qualitative characteristics of financial reporting as identified in Appendix 2 of IPSAS 1. These characteristics are also summarized in the Appendix 3 to this Standard. They include the relevance, reliability, and comparability over time of financial information that is reported about an entity's different segments. (These characteristics are based on the qualitative characteristics of financial statements identified in the IASC "Framework for the Preparation and Presentation of Financial Statements"); and
- (d) Whether a particular segment structure reflects the basis on which the governing body and senior manager require financial information to enable them to assess the past performance of the entity in achieving its objectives and to make decisions about the allocation of resources to achieve entity objectives in the future.

16. At the whole-of-government level, financial information is often aggregated and reported in a manner which reflects, for example:

- (a) Major economic classifications of activities undertaken by general government, such as health, education, defense, and welfare (these may reflect the Government Finance Statistics (GFS) functional classifications of government), and major trading activities undertaken by GBEs, such as state-owned power stations, banks and insurance entities; or
- (b) Portfolio responsibilities of individual ministers or members of executive government. These often, but not always, reflect the economic classifications in (a) above—differences may occur because portfolio responsibilities may aggregate more than one of the economic classifications or cut across those classifications.

### **Service Segments and Geographical Segments**

17. The types of segments reported to the governing body and senior manager of an entity are frequently referred to as service segments or geographical segments. These terms are used in this Standard with the following meanings:

- (a) A service segment refers to a distinguishable component of an entity that is engaged in providing related outputs or achieving particular

- operating objectives consistent with the overall mission of each entity;  
and
- (b) A geographical segment is a distinguishable component of an entity that is engaged in providing outputs or achieving particular operating objectives within a particular geographical area.
18. Government departments and agencies are usually managed along service lines because this reflects the way in which major outputs are identified, their achievements monitored and their resource needs identified and budgeted. An example of an entity which reports internally on the basis of service lines or service segments is an education department whose organizational structure and internal reporting system reflects primary, secondary and tertiary educational activities and outputs as separate segments. This basis of segmentation may be adopted internally because the skills and facilities necessary to deliver the desired outputs and outcomes for each of these broad educational activities are perceived to be different. In addition, key financial decisions faced by management include determination of the resources to allocate to each of those outputs or activities. In these cases, it is likely that reporting externally on the basis of service segments will also satisfy the requirements of this Standard.
19. Factors that will be considered in determining whether outputs (goods and services) are related and should be grouped as segments for financial reporting purposes include:
- (a) The primary operating objectives of the entity and the goods, services and activities that relate to the achievement of each of those objectives and whether resources are allocated and budgeted on the basis of groups of goods and services;
- (b) The nature of the goods or services provided or activities undertaken;
- (c) The nature of the production process and/or service delivery and distribution process or mechanism;
- (d) The type of customer or consumer for the goods or services;
- (e) Whether this reflects the way in which the entity is managed and financial information is reported to senior management and the governing board; and
- (f) If applicable, the nature of the regulatory environment, (for example, department or statutory authority) or sector of government (for example finance sector, public utilities, or general government).
20. An entity may be organized and report internally to the governing body and the senior manager on a regional basis—whether within or across national, state, local or other jurisdictional boundaries. Where this occurs the internal reporting system reflects a geographical segment structure.

21. A geographical segment structure may be adopted where, for example, the organizational structure and internal reporting system of an education department is structured on the basis of regional educational outcomes because the key performance assessments and resource allocation decisions to be made by the governing body and senior manager are determined by reference to regional achievements and regional needs. This structure may have been adopted to preserve regional autonomy of educational needs and delivery of education services, or because operating conditions or educational objectives are substantially different from one region to another. It may also have been adopted simply because management believes that an organizational structure based on regional devolution of responsibility better serves the objectives of the organization. In these cases, resource allocation decisions are initially made, and subsequently monitored, by the governing body and the senior manager on a regional basis. Detailed decisions about the allocation of resources to particular functional activities within a geographical region are then made by regional management, consistent with educational needs within that region. In these cases, it is likely that reporting information by geographical segments in the financial statements will also satisfy the requirements of this Standard.
22. Factors that will be considered in determining whether financial information should be reported on a geographical basis include:
- (a) Similarity of economic, social and political conditions in different regions;
  - (b) Relationships between the primary objectives of the entity and the different regions;
  - (c) Whether service delivery characteristics and operating conditions differ in different regions;
  - (d) Whether this reflects the way in which the entity is managed and financial information is reported to senior managers and the governing board; and
  - (e) Special needs, skills or risks associated with operations in a particular area.

### **Multiple Segmentation**

23. In some cases, an entity may report to the governing body and senior manager segment revenue, expense, assets and liabilities on the basis of more than one segment structure, for example by both service and geographical segments. Reporting on the basis of both service segments and geographical segments in the external financial statements often will provide useful information if the achievement of an entity's objectives is strongly affected both by the different products and services it provides and

the different geographical areas to which those goods and services are provided. Similarly, at the whole-of-government level, a government may adopt a basis of disclosure which reflects general government, public finance sector and trading sector disclosures, and supplement the general government sector analysis with, for example, segment disclosures of major purpose or functional sub-categories. In these cases, the segments may be reported separately or as a matrix. In addition, a primary and secondary segment reporting structure may be adopted with only limited disclosures made about secondary segments.

### **Reporting Structures Not Appropriate**

24. As noted above, in most cases the segments for which information is reported internally to the governing body and the most senior manager of the entity for the purpose of evaluating the entity's past performance and for making decisions about the future allocation of resources, will reflect those identified in budget documentation and will also be adopted for external reporting purposes in accordance with the requirements of this Standard. However, in some cases an entity's internal reporting to the governing body and the senior manager may be structured to aggregate and report on a basis which distinguishes revenues, expenses, assets and liabilities related to budget-dependent activities from those of trading activities, or which distinguishes budget-dependent entities from GBEs. Reporting segment information in the financial statements on the basis of only these segments is unlikely to meet the objectives specified for this Standard. This is because these segments are unlikely to provide information that is relevant to users about, for example, the performance of the entity in achieving its major operating objectives. IPSAS 22, "Disclosure of Financial Information about the General Government Sector" includes requirements for governments which elect to disclose financial information about the general government sector (GGS) as defined in statistical bases of reporting.
25. In some cases, the disaggregated financial information reported to the governing body and the senior manager may not report expenses, revenues, assets and liabilities by service segment, geographical segment or by reference to other activities. Such reports may be constructed to reflect only expenditures by nature (for example, wages, rent, supplies and capital acquisitions) on a line item basis that is consistent with the budget appropriation or other funding or expenditure authorization model applicable to the entity. This may occur where the purpose of financial reporting to the governing body and senior management is to evidence compliance with spending mandates rather than for purposes of evaluating the past performance of the entity's major activities in achieving their objectives and for making decisions about the future allocation of resources. When internal reporting to the governing body and senior manager is structured to report only compliance information, reporting externally on

the same basis as the internal reporting to the governing body and senior manager will not meet the requirement of this Standard.

26. When an entity's internal reporting structure does not reflect the requirements of this Standard, for external reporting purposes the entity will need to identify segments which satisfy the definition of a segment in paragraph 9 and disclose the information required by paragraphs 51-75.

### **Definitions of Segment Revenue, Expense, Assets, Liabilities and Accounting Policies**

27. The following additional terms are used in this Standard with the meanings specified:

**Segment revenue** is revenue reported in the entity's statement of financial performance that is directly attributable to a segment and the relevant portion of entity revenue that can be allocated on a reasonable basis to a segment, whether from budget appropriations or similar, grants, transfers, fines, fees or sales to external customers or from transactions with other segments of the same entity. Segment revenue does not include:

- (a) Interest or dividend revenue, including interest earned on advances or loans to other segments, unless the segment's operations are primarily of a financial nature; or
- (b) Gains on sales of investments or gains on extinguishment of debt unless the segment's operations are primarily of a financial nature.

Segment revenue includes an entity's share of net surplus (deficit) of associates, joint ventures, or other investments accounted for under the equity method only if those items are included in consolidated or total entity revenue.

Segment revenue includes a joint venturer's share of the revenue of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8, "Interests in Joint Ventures."

**Segment expense** is an expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to the provision of goods and services to external parties and expenses relating to transactions with other segments of the same entity. Segment expense does not include:

- (a) **Interest, including interest incurred on advances or loans from other segments, unless the segment's operations are primarily of a financial nature;**
- (b) **Losses on sales of investments or losses on extinguishment of debt unless the segment's operations are primarily of a financial nature;**
- (c) **An entity's share of net deficit or losses of associates, joint ventures, or other investments accounted for under the equity method;**
- (d) **Income tax or income-tax equivalent expense that is recognized in accordance with accounting standards dealing with obligations to pay income tax or income tax equivalents; or**
- (e) **General administrative expenses, head office expenses, and other expenses that arise at the entity level and relate to the entity as a whole. However, costs are sometimes incurred at the entity level on behalf of a segment. Such costs are segment expenses if they relate to the segment's operating activities and they can be directly attributed or allocated to the segment on a reasonable basis.**

**Segment expense includes a joint venturer's share of the expenses of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8.**

**For a segment's operations that are primarily of a financial nature, interest revenue and interest expense may be reported as a single net amount for segment reporting purposes only if those items are netted in the consolidated or entity financial statements.**

**Segment assets are those operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.**

**If a segment's segment revenue includes interest or dividend revenue, its segment assets include the related receivables, loans, investments, or other revenue-producing assets.**

**Segment assets do not include income tax or income tax equivalent assets that are recognized in accordance with accounting standards dealing with obligations to pay income tax or income tax equivalents.**

**Segment assets include investments accounted for under the equity method only if the net surplus (deficit) from such investments is included in segment revenue. Segment assets include a joint venturer's share of the operating assets of a jointly controlled entity that is**

accounted for by proportionate consolidation in accordance with IPSAS 8.

Segment assets are determined after deducting related allowances that are reported as direct offsets in the entity's statement of financial position.

**Segment liabilities** are those operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.

If a segment's segment expense includes interest expense, its segment liabilities include the related interest-bearing liabilities.

Segment liabilities include a joint venturer's share of the liabilities of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8.

Segment liabilities do not include income tax or income tax equivalent liabilities that are recognized in accordance with accounting standards dealing with obligations to pay income tax or income tax equivalents.

**Segment accounting policies** are the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity as well as those accounting policies that relate specifically to segment reporting.

#### **Attributing Items to Segments**

28. The definitions of segment revenue, segment expense, segment assets, and segment liabilities include amounts of such items that are directly attributable to a segment and amounts of such items that can be allocated to a segment on a reasonable basis.
29. An entity looks to its internal financial reporting system as the starting point for identifying those items that can be directly attributed, or reasonably allocated, to segments. That is, where segments used for internal reporting purposes are adopted, or form the basis of segments adopted, for general purpose financial statements, there is a presumption that amounts that have been identified with segments for internal financial reporting purposes are directly attributable or reasonably allocable to segments for the purpose of measuring the segment revenue, segment expense, segment assets and segment liabilities.
30. In some cases, a revenue, expense, asset or liability may have been allocated to segments for internal financial reporting purposes on a basis that is understood by entity management but that could be deemed subjective, arbitrary or difficult to understand by external users of financial statements.

Such an allocation would not constitute a reasonable basis under the definitions of segment revenue, segment expense, segment assets and segment liabilities in this Standard. Conversely, an entity may choose not to allocate some item of revenue, expense, asset or liability for internal financial reporting purposes, even though a reasonable basis for doing so exists. Such an item is allocated pursuant to the definitions of segment revenue, segment expense, segment assets and segment liabilities in this Standard.

31. Public sector entities can generally identify the costs of providing certain groups of goods and services or of undertaking certain activities and the assets that are necessary to facilitate those activities. This information is needed for planning and control purposes. However, in many cases the operations of government agencies and other public sector entities are funded by “block” appropriations, or appropriations on a “line item” basis reflecting the nature of the major classes of expenses or expenditures. These “block” or “line item” appropriations may not be related to specific service lines, functional activities or geographical regions. In some cases, it may not be possible to directly attribute revenue to a segment or to allocate it to a segment on a reasonable basis. Similarly, some assets, expenses and liabilities may not be able to be directly attributed, or allocated on a reasonable basis, to individual segments because they support a wide range of service delivery activities across a number of segments or are directly related to general administration activities which are not identified as a separate segment. The unattributed or unallocated revenue, expense, assets and liabilities would be reported as an unallocated amount in reconciling the segment disclosures to the aggregate entity revenue as required by paragraph 64 of this IPSAS.
32. Governments and their agencies may enter into arrangements with private sector entities for the delivery of goods and services or to conduct other activities. In some jurisdictions, these arrangements take the form of a joint venture or an investment in an associate which is accounted for by the equity method of accounting. Where this is the case, segment revenue will include the segment’s share of the equity accounted net surplus (deficit), where the equity accounted surplus (deficit) is included in entity revenue and it can be directly attributed or reliably allocated to the segment on a reasonable basis. In similar circumstances, segment revenue and segment expense will include the segment’s share of revenue and expense of a jointly controlled entity which is accounted for by proportionate consolidation.

#### **Segment Assets, Liabilities, Revenue and Expense**

33. Examples of segment assets include current assets that are used in the operating activities of the segment; property, plant and equipment; assets that are the subject of finance leases; and intangible assets. If a particular item of depreciation or amortization is included in segment expense, the

related asset is also included in segment assets. Segment assets do not include assets used for general entity or head office purposes, for example:

- (a) The office of the central administration and policy development unit of a department of education is not included in segments reflecting the delivery of primary, secondary and tertiary educational services; or
- (b) The parliamentary or other general assembly building is not included in segments reflecting major functional activities such as education, health and defense when reporting at the whole-of-government level.

Segment assets include operating assets shared by two or more segments if a reasonable basis for allocation exists.

- 34. The consolidated financial statements of a government or other entity may encompass entities acquired in an entity acquisition which gives rise to purchased goodwill (guidance on accounting for the acquisition of an entity is included in IFRS 3, “Business Combinations”). In these cases, segment assets will include goodwill that is directly attributable to a segment or that can be allocated to a segment on a reasonable basis, and segment expense includes related amortization of goodwill.
- 35. Examples of segment liabilities include trade and other payables, accrued liabilities, advances from members of the community for the provision of partially subsidized goods and services in the future, product warranty provisions arising from any commercial activities of the entity, and other claims relating to the provision of goods and services. Segment liabilities do not include borrowings, liabilities related to assets that are the subject of finance leases, and other liabilities that are incurred for financing rather than operating purposes. If interest expense is included in segment expense, the related interest-bearing liability is included in segment liabilities.
- 36. The liabilities of segments whose operations are not primarily of a financial nature do not include borrowings and similar liabilities because segment revenues and expenses do not include financing revenues and expenses. Further, because debt is often issued at the head office level or by a central borrowing authority on an entity-wide or government-wide basis, it is often not possible to directly attribute, or reasonably allocate, the interest-bearing liability to the segment. However, if the financing activities of the entity are identified as a separate segment, as may occur at the whole-of-government level, expenses of the “finance” segment will include interest expense, and the related interest-bearing liabilities will be included in segment liabilities.
- 37. International or national accounting standards may require adjustments to be made to the carrying amounts of the identifiable assets and liabilities of an entity acquired in an acquisition (see for example IFRS 3). Measurements of segment assets and liabilities include any adjustments to the prior carrying amounts of the identifiable segment assets and segment

liabilities of an entity acquired in an entity combination accounted for as a purchase, even if those adjustments are made only for the purpose of preparing consolidated financial statements and are not recorded in either the controlling entity's separate or the controlled entity's individual financial statements. Similarly, if property, plant, and equipment has been revalued subsequent to acquisition in accordance with the revaluation model in IPSAS 17, "Property, Plant and Equipment," measurements of segment assets reflect those revaluations.

38. In some jurisdictions, a government or government entity may control a GBE or other entity that operates on a commercial basis and is subject to income tax or income tax equivalents. These entities may be required to apply accounting standards such as IAS 12, "Income Taxes" which prescribe the accounting treatment of income taxes or income tax equivalents. Such standards may require the recognition of income tax assets and liabilities in respect of income tax expenses, or income tax equivalent expenses, which are recognized in the current period and are recoverable or repayable in future periods. These assets and liabilities are not included in segment assets or segment liabilities because they arise as a result of all the activities of the entity as a whole and the tax arrangements in place in respect of the entity. However, assets representing taxation revenue receivable which is controlled by a taxing authority will be included in segment assets of the authority if they can be directly attributed to that segment or allocated to it on a reliable basis.
39. Some guidance for cost allocation can be found in other International Public Sector Accounting Standards. For example, IPSAS 12, "Inventories" provides guidance for attributing and allocating costs to inventories, and IPSAS 11, "Construction Contracts" provides guidance for attributing and allocating costs to contracts. That guidance may be useful in attributing and allocating costs to segments.
40. IPSAS 2 provides guidance on whether bank overdrafts should be included as a component of cash or should be reported as borrowings.
41. The financial statements for the whole-of-government, and certain other controlling entities, will require the consolidation of a number of separate entities such as departments, agencies and GBEs. In preparing these consolidated financial statements transactions and balances between controlled entities will be eliminated in accordance with IPSAS 6, "Consolidated and Separate Financial Statements". However, segment revenue, segment expense, segment assets and segment liabilities are determined before balances and transactions between entities within the economic entity are eliminated as part of the consolidation process, except to the extent that such intra-economic entity balances and transactions are between entities within a single segment.

42. While the accounting policies used in preparing and presenting the financial statements of the entity as a whole are also the fundamental segment accounting policies, segment accounting policies include, in addition, policies that relate specifically to segment reporting, such as the method of pricing inter-segment transfers, and the basis for allocating revenues and expenses to segments.

### **Segment Accounting Policies**

43. **Segment information should be prepared in conformity with the accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity.**
44. There is a presumption that the accounting policies that the governing body and management of an entity have chosen to use in preparing the consolidated or entity-wide financial statements are those that the governing body and management believe are the most appropriate for external reporting purposes. Since the purpose of segment information is to help users of financial statements better understand and make more informed judgments about the entity as a whole, this Standard requires the use, in preparing segment information, of the accounting policies that the governing body and management have chosen for preparation of the consolidated or entity-wide financial statements. That does not mean, however, that the consolidated or entity accounting policies are to be applied to segments as if the segments were separate reporting entities. A detailed calculation done in applying a particular accounting policy at the entity-wide level may be allocated to segments if there is a reasonable basis for doing so. Employee entitlement calculations, for example, are often done for an entity as a whole, but the entity-wide figures may be allocated to segments based on salary and demographic data for the segments.
45. As noted in paragraph 42, accounting policies that deal with entity only issues such as inter-segment pricing may need to be developed. IPSAS 1 requires disclosure of accounting policies necessary to understand the financial statements. Consistent with those requirements, segment specific policies may need to be disclosed.
46. This Standard permits the disclosure of additional segment information that is prepared on a basis other than the accounting policies adopted for the consolidated or entity financial statements provided that:
- (a) The information is relevant for performance assessment and decision making purposes; and
  - (b) The basis of measurement for this additional information is clearly described.

## Joint Assets

47. **Assets that are jointly used by two or more segments should be allocated to segments if, and only if, their related revenues and expenses are also allocated to those segments.**
48. The way in which asset, liability, revenue and expense items are allocated to segments depends on such factors as the nature of those items, the activities conducted by the segment, and the relative autonomy of that segment. It is not possible or appropriate to specify a single basis of allocation that should be adopted by all entities. Nor is it appropriate to force allocation of entity asset, liability, revenue and expense items that relate jointly to two or more segments, if the only basis for making those allocations is arbitrary or difficult to understand. At the same time, the definitions of segment revenue, segment expense, segment assets and segment liabilities are interrelated, and the resulting allocations should be consistent. Therefore, jointly used assets are allocated to segments if, and only if, their related revenues and expenses are also allocated to those segments. For example, an asset is included in segment assets if, and only if, the related depreciation or amortization is included in measuring segment expense.

## Newly Identified Segments

49. **If a segment is identified as a segment for the first time in the current period, prior period segment data that is presented for comparative purposes should be restated to reflect the newly reported segment as a separate segment, unless it is impracticable to do so.**
50. New segments may be reported in financial statements in differing circumstances. For example, an entity may change its internal reporting structure from a service segment structure to a geographical segment structure and management may consider it appropriate that this segment structure also be adopted for external reporting purposes. An entity may also undertake significant new or additional activities, or increase the extent to which an activity previously operating as an internal support service provides services to external parties. In these cases, new segments may be reported for the first time in the general purpose financial statements. Where this occurs, this Standard requires that prior period comparative data should be restated to reflect the current segment structure where practicable.

## Disclosure

51. **The disclosure requirements in paragraphs 52–75 should be applied to each segment.**
52. **An entity should disclose segment revenue and segment expense for each segment. Segment revenue from budget appropriation or similar allocation, segment revenue from other external sources and segment**

**revenue from transactions with other segments should be separately reported.**

53. **An entity should disclose the total carrying amount of segment assets for each segment.**
54. **An entity should disclose the total carrying amount of segment liabilities for each segment.**
55. **An entity should disclose the total cost incurred during the period to acquire segment assets that are expected to be used during more than one period for each segment.**
56. An entity is encouraged, but not required, to disclose the nature and amount of any items of segment revenue and segment expense that are of such size, nature, or incidence that their disclosure is relevant to explain the performance of each segment for the period.
57. IPSAS 1 requires that when items of revenue or expense are material, their nature and amount of such items are disclosed separately. IPSAS 1 identifies a number of examples of such items, including write-downs of inventories and property, plant, and equipment; provisions for restructurings; disposals of property, plant, and equipment; privatizations and other disposals of long-term investments; discontinued operations; litigation settlements; and reversals of provisions. The encouragement in paragraph 56 is not intended to change the classification of any such items or to change the measurement of such items. The disclosure encouraged by that paragraph, however, does change the level at which the significance of such items is evaluated for disclosure purposes from the entity level to the segment level.
58. This Standard does not require a segment result to be disclosed. However, if a segment result is calculated and disclosed it is an operating result which does not include finance charges.
59. An entity is encouraged but not required to disclose segment cash flows consistent with the requirements of IPSAS 2. IPSAS 2 requires that an entity present a cash flow statement that separately reports cash flows from operating, investing, and financing activities. It also requires the disclosure of information about certain cash flows. The disclosure of cash flow information about each segment can be useful in understanding the entity's overall financial position, liquidity and cash flows.
60. An entity which does not disclose segment cash flows in accordance with IPSAS 2 is encouraged, but not required, to disclose for each reportable segment:
  - (a) Segment expense for depreciation and amortization of segment assets;

- (b) Other significant non-cash expenses; and
- (c) Significant non-cash revenues that are included in segment revenue.

This will enable users to determine the major sources and uses of cash in respect of segment activities for the period.

61. **An entity should disclose for each segment the aggregate of the entity's share of the net surplus (deficit) of associates, joint ventures, or other investments accounted for under the equity method if substantially all of those associates' operations are within that single segment.**
62. While a single aggregate amount is disclosed pursuant to the requirements of paragraph 61, each associate, joint venture or other equity method investment is assessed individually to determine whether its operations are substantially all within a segment.
63. **If an entity's aggregate share of the net surplus (deficit) of associates, joint venture, or other investments accounted for under the equity method is disclosed by segment, the aggregate investments in those associates and joint ventures should also be disclosed by segment.**
64. **An entity should present a reconciliation between the information disclosed for segments and the aggregated information in the consolidated or entity financial statements. In presenting the reconciliation, segment revenue should be reconciled to entity revenue from external sources (including disclosure of the amount of entity revenue from external sources not included in any segment's revenue); segment expense should be reconciled to a comparable measure of entity expense; segment assets should be reconciled to entity assets; and segment liabilities should be reconciled to entity liabilities.**

#### **Additional Segment Information**

65. As noted previously, it is anticipated that segments will usually be based on the major goods and services the entity provides, the programs it operates or the activities it undertakes. This is because information about these segments provides users with relevant information about the performance of the entity in achieving its objectives and enables the entity to discharge its accountability obligations. However, in some organizations, a geographical or other basis may better reflect the basis on which services are provided and resources allocated within the entity and, therefore, will be adopted for the financial statements.
66. This Standard adopts the view that disclosure of minimum information about both service segments and geographical segments is likely to be useful to users for accountability and decision-making purposes. Therefore, if an entity reports segment information on the basis of:

- (a) The major goods and services the entity provides, the programs it operates, the activities it undertakes or other service segments, it is also encouraged to report the following for each geographical segment that is reported internally to the governing body and the senior manager of the entity:
  - (i) Segment expense;
  - (ii) total carrying amount of segment assets; and
  - (iii) Total outlay during the period to acquire segment assets that are expected to be used during more than one period (property, plant, equipment and intangible assets); and
- (b) Geographical segments or another basis not encompassed by (a), the entity is encouraged to also report the following segment information for each major service segment that is reported internally to the governing body and the senior manager of the entity:
  - (i) Segment expense;
  - (ii) Total carrying amount of segment assets; and
  - (iii) Total outlay during the period to acquire segment assets that are expected to be used during more than one period (property, plant, equipment and intangible assets).

#### **Other Disclosure Matters**

- 67. **In measuring and reporting segment revenue from transactions with other segments, inter-segment transfers should be measured on the basis that they occur. The basis of pricing inter-segment transfers and any change therein should be disclosed in the financial statements.**
- 68. **Changes in accounting policies adopted for segment reporting that have a material effect on segment information should be disclosed, and prior period segment information presented for comparative purposes should be restated unless it is impracticable to do so. Such disclosure should include a description of the nature of the change, the reasons for the change, the fact that comparative information has been restated or that it is impracticable to do so, and the financial effect of the change if it is reasonably determinable. If an entity changes the identification of its segments and it does not restate prior period segment information on the new basis because it is impracticable to do so, then for the purpose of comparison an entity should report segment data for both the old and the new bases of segmentation in the year in which it changes the identification of its segments.**
- 69. Changes in accounting policies adopted by the entity are dealt with in IPSAS 3. IPSAS 3 requires that changes in accounting policy are made by

an IPSAS, or if the change will result in reliable and more relevant information about transactions, other events or conditions in the financial statements of the entity.

70. Changes in accounting policies applied at the entity level that affect segment information are dealt with in accordance with IPSAS 3. Unless a new IPSAS specifies otherwise, IPSAS 3 requires that:
- (a) A change in accounting policy be applied retrospectively and that prior period information be restated unless it is impracticable to determine either the cumulative effect or the period specific effects of the change;
  - (b) If retrospective application is not practicable for all periods presented, the new accounting policy shall be applied retrospectively from the earliest practicable date; and
  - (c) If it is impracticable to determine the cumulative effect of applying the new accounting policy at the start of the current period, the policy shall be applied prospectively from the earliest date practicable.
71. Some changes in accounting policies relate specifically to segment reporting. Examples include changes in identification of segments and changes in the basis for allocating revenues and expenses to segments. Such changes can have a significant impact on the segment information reported but will not change aggregate financial information reported for the entity. To enable users to understand the changes and to assess trends, prior period segment information that is included in the financial statements for comparative purposes is restated, if practicable, to reflect the new accounting policy.
72. Paragraph 67 requires that, for segment reporting purposes, inter-segment transfers should be measured on the basis that the entity actually used to price those transfers. If an entity changes the method that it actually uses to price inter-segment transfers, that is not a change in accounting policy for which prior period segment data should be restated pursuant to paragraph 68. However, paragraph 67 requires disclosure of the change.
73. **If not otherwise disclosed in the financial statements or elsewhere in the annual report, an entity should indicate:**
- (a) **The types of goods and services included in each reported service segment;**
  - (b) **The composition of each reported geographical segment; and**
  - (c) **If neither a service nor geographical basis of segmentation is adopted, the nature of the segment and activities encompassed by it.**

**Segment Operating Objectives**

74. If not otherwise disclosed in the financial statements or elsewhere in the annual report, the entity is encouraged to disclose the broad operating objectives established for each segment at the commencement of the reporting period and to comment on the extent to which those objectives were achieved.
75. To enable users to assess the performance of an entity in achieving its service delivery objectives it is necessary to communicate those objectives to users. The disclosure of information about the composition of each segment, the service delivery objectives of those segments and the extent to which those objectives were achieved will support this assessment. This information will also enable the entity to better discharge its accountability obligations. In many cases, this information will be included in the annual report as part of the report of the governing body or the senior manager. In such cases, disclosure of this information in the financial statements is not necessary.

**Effective Date**

76. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after July 1, 2003. Earlier application is encouraged.**
77. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

**Appendix 1****Illustrative Segment Disclosures**

*The appendix is illustrative only and does not form part of the Standard. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.*

The schedule and related note presented in this appendix illustrate the segment disclosures that this Standard would require for an education authority which is predominantly funded by appropriation but provides some educational services on a commercial basis to the employees of major corporations and has joined with a commercial venture to establish a private education foundation which operates on a commercial basis. The Authority has significant influence over, but does not control that foundation. For illustrative purposes, the example presents comparative data for two years. Segment data is required for each year for which a complete set of financial statements is presented.

SEGMENT REPORTING

**SCHEDULE A—INFORMATION ABOUT SEGMENTS** (in millions of currency units)

	Primary/Secondary		Tertiary		Special Services		Other Services		Eliminations		Consolidated	
	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1
<b>SEGMENT REVENUE</b>												
Appropriation	48	40	22	23	10	10	7	7				
Fees from external sources	5	4	–	–	9	6	–	–				
Inter-segment transfers	<u>10</u>	<u>6</u>	<u>6</u>	<u>7</u>	<u>2</u>	<u>4</u>	<u>2</u>	<u>2</u>				
<b>Total Segment Revenue</b>	<u>63</u>	<u>50</u>	<u>28</u>	<u>30</u>	<u>21</u>	<u>20</u>	<u>9</u>	<u>9</u>	<u>20</u>	19	101	90
<b>SEGMENT EXPENSE</b>												
Salaries and wages	(39)	(31)	(13)	(13)	(13)	(13)	(2)	(2)				
Depreciation	(9)	(7)	(5)	(7)	(5)	(3)	(1)	(1)				
Other expenses	<u>(12)</u>	<u>(11)</u>	<u>(10)</u>	<u>(9)</u>	<u>(5)</u>	<u>(5)</u>	<u>(2)</u>	<u>(2)</u>				
<b>Total Segment Expenses</b>	<u>(60)</u>	<u>(49)</u>	<u>(28)</u>	<u>(29)</u>	<u>(23)</u>	<u>(21)</u>	<u>(5)</u>	<u>(5)</u>	<u>20</u>	<u>19</u>	(96)	(85)
Unallocated central expenses											<u>(7)</u>	<u>(9)</u>
<b>Deficit from Operating Activities</b>											(2)	(4)
Interest expense											(4)	(3)
Interest revenue											2	3
Share of net surpluses of associates							8	7			8	7
<b>Surplus from Ordinary Activities</b>											4	3
Extraordinary loss: uninsured earthquake damage to facilities		(3)									0	(3)
<b>Net Surplus</b>											<u>4</u>	<u>0</u>

SEGMENT REPORTING

**SCHEDULE A—INFORMATION ABOUT SEGMENTS** (in millions of currency units)

	Primary/Secondary		Tertiary		Special Services		Other Services		Eliminations	Consolidated	
<b>OTHER INFORMATION</b>											
Segment assets	54	50	34	30	10	10	10	9		108	99
Investment in associates (equity method )							32	26		32	26
Unallocated central assets										<u>35</u>	<u>30</u>
<b>Consolidated Total Assets</b>										<u>175</u>	<u>155</u>
Segment liabilities	25	15	8	11	8	8	1	1		42	35
Unallocated corporate liabilities										<u>40</u>	<u>55</u>
<b>Consolidated Total Liabilities</b>										<u>82</u>	<u>90</u>
Capital expenditure	13	10	9	5	4	0	2	3			
Non-cash expense excluding depreciation	(8)	(2)	(3)	(3)	(2)	(2)	(1)	(1)			
Non-cash revenue	–	–	–	–	1	1	–	–			

**Note: Segments (all amounts are in millions of currency units)**

The Authority is organized and reports to the governing body on the basis of four major functional areas: primary and secondary education; tertiary education; special education services; and other services, each headed by a director. Operations of the special education services segment includes provision of educational services on a commercial basis to the employees of major corporations. In providing these services to external parties the commercial services unit of the segment uses, on a fee for service basis, services provided by the primary/secondary and tertiary segments. These inter segment transfers are eliminated on consolidation.

Information reported about these segments is used by the governing board and senior management as a basis for evaluating the entity's past performance in achieving its objectives and for making decisions about the future allocation of resources. The disclosure of information about these segments is also considered appropriate for external reporting purposes.

The majority of the Authority's operations are domestic except that as part of an aid program it has established facilities in Eastern Europe for the provision of secondary educational services. Total cost of services provided in Eastern Europe is 5 million (4 million in 20X1). Total carrying amount of the educational facilities in Eastern Europe are 3 million (6.5 million in 20X1). There were no outlays on the acquisition of capital assets in Eastern Europe during 20X2 or 20X1.

Inter-segment transfers: segment revenue and segment expense include revenue and expense arising from transfers between segments. Such transfers are usually accounted for at cost and are eliminated on consolidation. The amount of these transfers was 20 million (19 million in 19X1).

Investments in associates are accounted for using the equity method. The Authority owns 40% of the capital stock of EuroED Ltd, a specialist education foundation providing educational services internationally on a commercial basis under contract to multilateral lending agencies. The investment is accounted for by the equity method. The investment in, and the Authority's share of, EuroED's net profit are excluded from segment assets and segment revenue.

However they are shown separately under the other services segment, which is responsible for the administration of the investment in the associate.

A full report of the objectives established for each segment and the extent to which those objectives have been achieved is included in the Review of Operations, included elsewhere in this report.

### Summary of Required Disclosures

The appendix is illustrative only and does not form part of the Standard. Its purpose is to summarize the disclosures required by paragraphs 52-75.

[¶xx] refers to paragraph xx in the Standard.

#### *Disclosures*

Total expense by segment [¶52]

Total revenue by segment [¶52]

Revenue from budget appropriation or similar allocation by segment [¶52]

Revenue from external sources (other than appropriation or similar allocation) by segment [¶52]

Revenue from transactions with other segments by segment [¶52]

Carrying amount of segment assets by segment [¶53]

Segment liabilities by segment [¶54]

Cost to acquire assets by segment [¶55]

Share of net surplus (deficit) of [¶61] and investment in [¶63] equity method associates or joint ventures by segment (if substantially all within a single segment)

Reconciliation of revenue, expense, assets and liabilities by segment [¶64]

#### *Other Disclosures*

Basis of pricing inter-segment transfers and any changes therein [¶67]

Changes in segment accounting policies [¶68]

Types of products and services in each service segment [¶73]

Composition of each geographical segment [¶73]

If neither a service nor geographical basis of segmentation is adopted, the nature of the segments and activities encompassed by each segment [¶73]

## Appendix 3

### Qualitative Characteristics of Financial Reporting

Paragraph 15 of this Standard requires the development of accounting policies to ensure that the financial statements provide information that meets a number of qualitative characteristics. This appendix summarizes the qualitative characteristics of financial reporting.

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

#### *Understandability*

Information is understandable when users might reasonably be expected to comprehend its meaning. For this purpose, users are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, and to be willing to study the information.

Information about complex matters should not be excluded from the financial statements merely on the grounds that it may be too difficult for certain users to understand.

#### *Relevance*

Information is relevant to users if it can be used to assist in evaluating past, present or future events or in confirming or correcting past evaluations. In order to be relevant, information must also be timely.

#### *Materiality*

The relevance of information is affected by its nature and materiality.

Information is material if its omission or misstatement could influence the decisions of users or assessments made on the basis of the financial statements. Materiality depends on the nature or size of the item or error judged in the particular circumstances of its omission or misstatement. Thus, materiality provides a threshold or cut-off point rather than being a primary qualitative characteristic which information must have if it is to be useful.

#### *Reliability*

Reliable information is free from material error and bias, and can be depended on by users to represent faithfully that which it purports to represent or could reasonably be expected to represent.

*Faithful Representation*

For information to represent faithfully transactions and other events, it should be presented in accordance with the substance of the transactions and other events, and not merely their legal form.

*Substance Over Form*

If information is to represent faithfully the transactions and other events that it purports to represent, it is necessary that they are accounted for and presented in accordance with their substance and economic reality and not merely their legal form. The substance of transactions or other events is not always consistent with their legal form.

*Neutrality*

Information is neutral if it is free from bias. Financial statements are not neutral if the information they contain has been selected or presented in a manner designed to influence the making of a decision or judgment in order to achieve a predetermined result or outcome.

*Prudence*

Prudence is the inclusion of a degree of caution in the exercise of the judgments needed in making the estimates required under conditions of uncertainty, such that assets or revenue are not overstated and liabilities or expenses are not understated.

However, the exercise of prudence does not allow, for example, the creation of hidden reserves or excessive provisions, the deliberate understatement of assets or revenue, or the deliberate overstatement of liabilities or expenses, because the financial statements would not be neutral and, therefore, not have the quality of reliability.

*Completeness*

The information in financial statements should be complete within the bounds of materiality and cost.

*Comparability*

Information in financial statements is comparable when users are able to identify similarities and differences between that information and information in other reports.

Comparability applies to the:

- Comparison of financial statements of different entities; and
- Comparison of the financial statements of the same entity over periods of time.

An important implication of the characteristic of comparability is that users need to be informed of the policies employed in the preparation of financial statements, changes to those policies and the effects of those changes.

Because users wish to compare the performance of an entity over time, it is important that financial statements show corresponding information for preceding periods.

### **Constraints on Relevant and Reliable Information**

#### *Timeliness*

If there is an undue delay in the reporting of information it may lose its relevance. To provide information on a timely basis it may often be necessary to report before all aspects of a transaction are known, thus impairing reliability. Conversely, if reporting is delayed until all aspects are known, the information may be highly reliable but of little use to users who have had to make decisions in the interim. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the decision-making needs of users.

#### *Balance between Benefit and Cost*

The balance between benefit and cost is a pervasive constraint. The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is, however, substantially a matter of judgment. Furthermore, the costs do not always fall on those users who enjoy the benefits. Benefits may also be enjoyed by users other than those for whom the information was prepared. For these reasons, it is difficult to apply a benefit-cost test in any particular case. Nevertheless, standard-setters, as well as those responsible for the preparation of financial statements and users of financial statements, should be aware of this constraint.

#### *Balance between Qualitative Characteristics*

In practice a balancing, or trade-off, between qualitative characteristics is often necessary. Generally the aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial statements. The relative importance of the characteristics in different cases is a matter of professional judgment.

### Comparison with IAS 14

IPSAS 18, “Segment Reporting” is drawn primarily from IAS 14, “Segment Reporting” (revised 1997). The main differences between IPSAS 18 and IAS 14 are as follows:

- IPSAS 18 defines segments differently from IAS 14. IPSAS 18 requires entities to report segments on a basis appropriate for assessing past performance and making decision about the allocation of resources. IAS 14 requires business and geographical segments to be reported.
- Commentary additional to that in IAS 14 has been included in IPSAS 18 to clarify the applicability of the standards to accounting by public sector entities.
- IAS 14 requires disclosure of segment result, depreciation and amortization of segment assets and other significant non-cash expenses. IPSAS 18 does not require the disclosure of segment result. IPSAS 18 encourages, but does not require, the disclosure of significant non-cash revenues that are included in segment revenue, segment depreciation and other non-cash expenses or segment cash flows as required by IPSAS 2, “Cash Flow Statements.”
- IPSAS 18 does not require the disclosure of information about secondary segments, but encourages certain minimum disclosures about both service and geographical segments.
- IPSAS 18 does not specify quantitative thresholds that must be applied in identifying reportable segments.
- IPSAS 18 uses different terminology, in certain instances, from IAS 14. The most significant examples are the use of the terms entity, revenue,” statement of financial performance, statement of financial position and net assets/equity. The equivalent terms in IAS 14 are enterprise, income, income statement, balance sheet and equity.

## **IPSAS 19—PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS**

### **Acknowledgment**

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 37 (1998), “Provisions, Contingent Liabilities and Contingent Assets” published by the International Accounting Standards Board (IASB). Extracts from IAS 37 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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**IPSAS 19—PROVISIONS, CONTINGENT LIABILITIES  
AND CONTINGENT ASSETS**

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*The standards, which have been set in bold type, should be read in the context of the commentary paragraphs in this Standard, which are in plain type, and in the context of the “Preface to International Public Sector Accounting Standards.” International Public Sector Accounting Standards are not intended to apply to immaterial items.*

## **Objective**

The objective of this Standard is to define provisions, contingent liabilities and contingent assets, identify the circumstances in which provisions should be recognized, how they should be measured and the disclosures that should be made about them. The Standard also requires that certain information be disclosed about contingent liabilities and contingent assets in the notes to the financial statements to enable users to understand their nature, timing and amount.

## **Scope**

1. **An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in accounting for provisions, contingent liabilities and contingent assets, except:**
  - (a) **Those provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits;**
  - (b) **Those resulting from financial instruments that are carried at fair value;**
  - (c) **Those resulting from executory contracts, other than where the contract is onerous subject to other provisions of this paragraph;**
  - (d) **Those arising in insurance entities from contracts with policyholders;**
  - (e) **Those covered by another International Public Sector Accounting Standard;**
  - (f) **Those arising in relation to income taxes or income tax equivalents; and**
  - (g) **Those arising from employee benefits except employee termination benefits that arise as a result of a restructuring as dealt with in this Standard.**
2. **This Standard applies to all public sector entities other than Government Business Enterprises.**
3. The “Preface to International Public Sector Accounting Standards” issued by the International Public Sector Accounting Standards Board (IPSASB)

explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, “Presentation of Financial Statements.”

4. This Standard applies to financial instruments (including guarantees) that are not carried at fair value.
5. This Standard applies to provisions, contingent liabilities and contingent assets of insurance entities other than those arising from contracts with policyholders.
6. This Standard applies to provisions for restructuring (including discontinuing operations). In some cases, a restructuring may meet the definition of a discontinuing operation. Guidance on disclosing information about discontinuing operations is found in International Accounting Standard (IAS) 35, “Discontinuing Operations.”<sup>1</sup>

### **Social Benefits**

7. For the purposes of this Standard “social benefits” refer to goods, services and other benefits provided in the pursuit of the social policy objectives of a government. These benefits may include:
  - (a) The delivery of health, education, housing, transport and other social services to the community. In many cases, there is no requirement for the beneficiaries of these services to pay an amount equivalent to the value of these services; and
  - (b) Payment of benefits to families, the aged, the disabled, the unemployed, veterans and others. That is, governments at all levels may provide financial assistance to individuals and groups in the community to access services to meet their particular needs, or to supplement their income.

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<sup>1</sup> The Committee has not yet addressed the issue of discontinuing operations, which is the subject of International Accounting Standard (IAS) 35, “Discontinuing Operations.” Consistent with the definition in IAS 35, the term discontinuing operation as used in this Standard refers to a component of an entity:

- (a) That the entity, pursuant to a single plan, is:
  - (i) disposing of substantially in its entirety, such as by selling the component in a single transaction, by demerger or spin-off of ownership of the component to the entity’s owners;
  - (ii) disposing of piecemeal, such as by selling off the component’s assets and settling its liabilities individually; or
  - (iii) terminating through abandonment;
- (b) That represents a separate major activity/line of business or geographical area of operations; and
- (c) That can be distinguished operationally and for financial reporting purposes.

8. In many cases, obligations to provide social benefits arise as a consequence of a government's commitment to undertake particular activities on an on-going basis over the long term in order to provide particular goods and services to the community. The need for, and nature and supply of, goods and services to meet social policy obligations will often depend on a range of demographic and social conditions and are difficult to predict. These benefits generally fall within the social protection, education and health classifications under the International Monetary Fund's Government Finance Statistics framework and often require an actuarial assessment to determine the amount of any liability arising in respect of them.
9. For a provision or contingency arising from a social benefit to be excluded from the scope of this Standard, the public sector entity providing the benefit will not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of the benefit. This exclusion would encompass those circumstances where a charge is levied in respect of the benefit but there is no direct relationship between the charge and the benefit received. The exclusion of these provisions and contingent liabilities from the scope of this Standard reflects the Committee's view that both the determination of what constitutes the obligating event and the measurement of the liability require further consideration before proposed Standards are exposed. For example, the Committee is aware that there are differing views about whether the obligating event occurs when the individual meets the eligibility criteria for the benefit or at some earlier stage. Similarly, there are differing views about whether the amount of any obligation reflects an estimate of the current period's entitlement or the present value of all expected future benefits determined on an actuarial basis.
10. Where an entity elects to recognize a provision for such obligations, the entity discloses the basis on which the provisions have been recognized and the measurement basis adopted. The entity also makes other disclosures required by this Standard in respect of those provisions. IPSAS 1, "Presentation of Financial Statements," provides guidance on dealing with matters not specifically dealt with by another IPSAS. IPSAS 1 also includes requirements relating to the selection and disclosure of accounting policies.
11. In some cases, social benefits may give rise to a liability for which there is:
  - (a) Little or no uncertainty as to amount; and
  - (b) The timing of the obligation is not uncertain.

Accordingly, these are not likely to meet the definition of a provision in this Standard. Where such liabilities for social benefits exist, they are recognized where they satisfy the criteria for recognition as liabilities (refer also to paragraph 19). An example would be a period-end accrual for an amount owing to the existing beneficiaries in respect of aged or

disability pensions that have been approved for payment consistent with the provisions of a contract or legislation.

**Other Exclusions from the Scope of the Standard**

12. This Standard does not apply to executory contracts unless they are onerous. Contracts to provide social benefits entered into with the expectation that the entity will not receive consideration that is approximately equal to the value of goods and services provided directly in return from the recipients of those benefits are excluded from the scope of this Standard.
13. Where another International Public Sector Accounting Standard deals with a specific type of provision, contingent liability or contingent asset, an entity applies that Standard instead of this Standard. For example, certain types of provisions are also addressed in Standards on:
  - (a) Construction contracts (see IPSAS 11, “Construction Contracts”); and
  - (b) Leases (see IPSAS 13, “Leases”). However, as IPSAS 13 contains no specific requirements to deal with operating leases that have become onerous, this Standard applies to such cases.
14. This Standard does not apply to provisions for income taxes or income tax equivalents (guidance on accounting for income taxes is found in IAS 12, “Income Taxes”). Nor does it apply to provisions arising from employee benefits (guidance on accounting for employee benefits is found in IAS 19, “Employee Benefits”).
15. Some amounts treated as provisions may relate to the recognition of revenue, for example where an entity gives guarantees in exchange for a fee. This Standard does not address the recognition of revenue. IPSAS 9, “Revenue from Exchange Transactions,” identifies the circumstances in which revenue from exchange transactions is recognized and provides practical guidance on the application of the recognition criteria. This Standard does not change the requirements of IPSAS 9.
16. This Standard defines provisions as liabilities of uncertain timing or amount. In some countries the term provision is also used in the context of items such as depreciation, impairment of assets and doubtful debts: these are adjustments to the carrying amounts of assets and are not addressed in this Standard.
17. Other International Public Sector Accounting Standards specify whether expenditures are treated as assets or as expenses. These issues are not addressed in this Standard. Accordingly, this Standard neither prohibits nor requires capitalization of the costs recognized when a provision is made.

## Definitions

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

A **constructive obligation** is an obligation that derives from an entity's actions where:

- (a) By an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and
- (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

A **contingent asset** is a possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.

A **contingent liability** is:

- (a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or
- (b) A present obligation that arises from past events but is not recognized because:
  - (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or
  - (ii) The amount of the obligation cannot be measured with sufficient reliability.

**Executory contracts** are contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.

A **legal obligation** is an obligation that derives from:

- (a) A contract (through its explicit or implicit terms);
- (b) Legislation; or
- (c) Other operation of law.

**Liabilities** are present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.

**An obligating event is an event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.**

**An onerous contract is a contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.**

**A provision is a liability of uncertain timing or amount.**

**A restructuring is a program that is planned and controlled by management, and materially changes either:**

- (a) **The scope of an entity's activities; or**
- (b) **The manner in which those activities are carried out.**

### **Provisions and Other Liabilities**

19. Provisions can be distinguished from other liabilities such as payables and accruals because there is uncertainty about the timing or amount of the future expenditure required in settlement. By contrast:
- (a) Payables are liabilities to pay for goods or services that have been received or supplied and have been invoiced or formally agreed with the supplier (and include payments in respect of social benefits where formal agreements for specified amounts exist); and
  - (b) Accruals are liabilities to pay for goods or services that have been received or supplied but have not been paid, invoiced or formally agreed with the supplier, including amounts due to employees (for example, amounts relating to accrued vacation pay). Although it is sometimes necessary to estimate the amount or timing of accruals, the uncertainty is generally much less than for provisions.

Accruals are often reported as part of accounts payable, whereas provisions are reported separately.

### **Relationship between Provisions and Contingent Liabilities**

20. In a general sense, all provisions are contingent because they are uncertain in timing or amount. However, within this Standard the term contingent is used for liabilities and assets that are not recognized because their existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity. In addition, the term contingent liability is used for liabilities that do not meet the recognition criteria.
21. This Standard distinguishes between:

- (a) Provisions—which are recognized as liabilities (assuming that a reliable estimate can be made) because they are present obligations and it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligations; and
- (b) Contingent liabilities—which are not recognized as liabilities because they are either:
  - (i) Possible obligations, as it has yet to be confirmed whether the entity has a present obligation that could lead to an outflow of resources embodying economic benefits or service potential; or
  - (ii) Present obligations that do not meet the recognition criteria in this Standard (because either it is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, or a sufficiently reliable estimate of the amount of the obligation cannot be made).

## Recognition

### Provisions

22. **A provision should be recognized when:**
- (a) **An entity has a present obligation (legal or constructive) as a result of a past event;**
  - (b) **It is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; and**
  - (c) **A reliable estimate can be made of the amount of the obligation.**
- If these conditions are not met, no provision should be recognized.**

### Present Obligation

23. **In some cases it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the reporting date.**
24. In most cases it will be clear whether a past event has given rise to a present obligation. In other cases, for example in a lawsuit, it may be disputed either whether certain events have occurred or whether those events result in a present obligation. In such cases, an entity determines whether a present obligation exists at the reporting date by taking account of all available evidence, including, for example, the opinion of experts.

PROVISIONS, CONTINGENT LIABILITIES  
AND CONTINGENT ASSETS

The evidence considered includes any additional evidence provided by events after the reporting date. On the basis of such evidence:

- (a) Where it is more likely than not that a present obligation exists at the reporting date, the entity recognizes a provision (if the recognition criteria are met); and
- (b) Where it is more likely that no present obligation exists at the reporting date, the entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph 100).

*Past Event*

- 25. A past event that leads to a present obligation is called an obligating event. For an event to be an obligating event, it is necessary that the entity has no realistic alternative to settling the obligation created by the event. This is the case only:
  - (a) Where the settlement of the obligation can be enforced by law; or
  - (b) In the case of a constructive obligation, where the event (which may be an action of the entity) creates valid expectations in other parties that the entity will discharge the obligation.
- 26. Financial statements deal with the financial position of an entity at the end of its reporting period and not its possible position in the future. Therefore, no provision is recognized for costs that need to be incurred to continue an entity's ongoing activities in the future. The only liabilities recognized in an entity's statement of financial position are those that exist at the reporting date.
- 27. It is only those obligations arising from past events existing independently of an entity's future actions (that is, the future conduct of its activities) that are recognized as provisions. Examples of such obligations are penalties or clean-up costs for unlawful environmental damage imposed by legislation on a public sector entity. Both of these obligations would lead to an outflow of resources embodying economic benefits or service potential in settlement regardless of the future actions of that public sector entity. Similarly, a public sector entity would recognize a provision for the decommissioning costs of a defense installation or a government-owned nuclear power station to the extent that the public sector entity is obliged to rectify damage already caused IPSAS 17, "Property, Plant and Equipment," deals with items, including dismantling and site restoring costs, that are included in the cost of an asset). In contrast, because of legal requirements, pressure from constituents, or a desire to demonstrate community leadership, an entity may intend or need to carry out expenditure to operate in a particular way in the future. An example would

be where a public sector entity decides to fit emission controls on certain of its vehicles or a government laboratory decides to install extraction units to protect employees from the fumes of certain chemicals. Because the entities can avoid the future expenditure by their future actions — for example, by changing their method of operation, they have no present obligation for that future expenditure and no provision is recognized.

28. An obligation always involves another party to whom the obligation is owed. It is not necessary, however, to know the identity of the party to whom the obligation is owed — indeed the obligation may be to the public at large. Because an obligation always involves a commitment to another party, it follows that a decision by an entity's management, governing body or controlling entity does not give rise to a constructive obligation at the reporting date unless the decision has been communicated before the reporting date to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will discharge its responsibilities.
29. An event that does not give rise to an obligation immediately may do so at a later date, because of changes in the law or because an act (for example, a sufficiently specific public statement) by the entity gives rise to a constructive obligation. For example, when environmental damage is caused by a government agency there may be no obligation to remedy the consequences. However, the causing of the damage will become an obligating event when a new law requires the existing damage to be rectified or when the controlling government or the individual agency publicly accepts responsibility for rectification in a way that creates a constructive obligation.
30. Where details of a proposed new law have yet to be finalized, an obligation arises only when the legislation is virtually certain to be enacted as drafted. For the purpose of this Standard, such an obligation is treated as a legal obligation. However, differences in circumstances surrounding enactment often make it impossible to specify a single event that would make the enactment of a law virtually certain. In many cases, it is not possible to judge whether a proposed new law is virtually certain to be enacted as drafted and any decision about the existence of an obligation should await the enactment of the proposed law.

*Probable Outflow of Resources Embodying Economic Benefits or Service Potential*

31. For a liability to qualify for recognition there must be not only a present obligation but also the probability of an outflow of resources embodying economic benefits or service potential to settle that obligation. For the purpose of this Standard, an outflow of resources or other event is regarded as probable if the event is more likely than not to occur, that is, the probability that the event will occur is greater than the probability that it

will not. Where it is not probable that a present obligation exists, an entity discloses a contingent liability, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote (see paragraph 100).

32. Where there are a number of similar obligations (for example, a government's obligation to compensate individuals who have received contaminated blood from a government-owned hospital) the probability that an outflow will be required in settlement is determined by considering the class of obligations as a whole. Although the likelihood of outflow for any one item may be small, it may well be probable that some outflow of resources will be needed to settle the class of obligations as a whole. If that is the case, a provision is recognized (if the other recognition criteria are met).

*Reliable Estimate of the Obligation*

33. The use of estimates is an essential part of the preparation of financial statements and does not undermine their reliability. This is especially true in the case of provisions, which by their nature are more uncertain than most other assets or liabilities. Except in extremely rare cases, an entity will be able to determine a range of possible outcomes and can therefore make an estimate of the obligation that is sufficiently reliable to use in recognizing a provision.
34. In the extremely rare case where no reliable estimate can be made, a liability exists that cannot be recognized. That liability is disclosed as a contingent liability (see paragraph 100).

**Contingent Liabilities**

35. **An entity should not recognize a contingent liability.**
36. A contingent liability is disclosed, as required by paragraph 100, unless the possibility of an outflow of resources embodying economic benefits or service potential is remote.
37. Where an entity is jointly and severally liable for an obligation the part of the obligation that is expected to be met by other parties is treated as a contingent liability. For example, in the case of joint venture debt, that part of the obligation that is to be met by other joint venture participants is treated as a contingent liability. The entity recognizes a provision for the part of the obligation for which an outflow of resources embodying economic benefits or service potential is probable, except in the rare circumstances where no reliable estimate can be made.
38. Contingent liabilities may develop in a way not initially expected. Therefore, they are assessed continually to determine whether an outflow of resources embodying economic benefits or service potential has become probable. If it becomes probable that an outflow of future economic

benefits or service potential will be required for an item previously dealt with as a contingent liability, a provision is recognized in the financial statements of the period in which the change in probability occurs (except in the extremely rare circumstances where no reliable estimate can be made). For example, a local government entity may have breached an environmental law but it remains unclear whether any damage was caused to the environment. Where, subsequently it becomes clear that damage was caused and remediation will be required, the entity would recognize a provision because an outflow of economic benefits is now probable.

### Contingent Assets

39. **An entity should not recognize a contingent asset.**
40. Contingent assets usually arise from unplanned or other unexpected events that are not wholly within the control of the entity and give rise to the possibility of an inflow of economic benefits or service potential to the entity. An example is a claim that an entity is pursuing through legal processes, where the outcome is uncertain.
41. Contingent assets are not recognized in financial statements since this may result in the recognition of revenue that may never be realized. However, when the realization of revenue is virtually certain, then the related asset is not a contingent asset and its recognition is appropriate.
42. A contingent asset is disclosed, as required by paragraph 105, where an inflow of economic benefits or service potential is probable.
43. Contingent assets are assessed continually to ensure that developments are appropriately reflected in the financial statements. If it has become virtually certain that an inflow of economic benefits or service potential will arise and the asset's value can be measured reliably, the asset and the related revenue are recognized in the financial statements of the period in which the change occurs. If an inflow of economic benefits or service potential has become probable, an entity discloses the contingent asset (see paragraph 105).

### Measurement

#### Best Estimate

44. **The amount recognized as a provision should be the best estimate of the expenditure required to settle the present obligation at the reporting date.**
45. The best estimate of the expenditure required to settle the present obligation is the amount that an entity would rationally pay to settle the obligation at the reporting date or to transfer it to a third party at that time. It will often be impossible or prohibitively expensive to settle or transfer an

obligation at the reporting date. However, the estimate of the amount that an entity would rationally pay to settle or transfer the obligation gives the best estimate of the expenditure required to settle the present obligation at the reporting date.

46. The estimates of outcome and financial effect are determined by the judgment of the management of the entity, supplemented by experience of similar transactions and, in some cases, reports from independent experts. The evidence considered includes any additional evidence provided by events after the reporting date.

*Example*

A government medical laboratory provides diagnostic ultrasound scanners to both government owned and privately owned medical centers and hospitals on a full cost recovery basis. The equipment is provided with a warranty under which the medical centers and hospitals are covered for the cost of repairs of any defects that become apparent within the first six months after purchase. If minor defects were detected in all equipment provided, repair costs of 1 million currency units would result. If major defects were detected in all equipment provided, repair costs of 4 million currency units would result. The laboratory's past experience and future expectations indicate that, for the coming year, 75% of the equipment will have no defects, 20% of the equipment will have minor defects and 5% of the equipment will have major defects. In accordance with paragraph 32, the laboratory assesses the probability of an outflow for the warranty obligations as a whole.

The expected value of the cost of repairs is:

$$(75\% \text{ of nil}) + (20\% \text{ of } 1\text{m}) + (5\% \text{ of } 4\text{m}) = 400,000$$

47. Uncertainties surrounding the amount to be recognized as a provision are dealt with by various means according to the circumstances. Where the provision being measured involves a large population of items, the obligation is estimated by weighting all possible outcomes by their associated probabilities. The name for this statistical method of estimation is expected value. The provision will therefore be different depending on whether the probability of a loss of a given amount is, for example, 60% or 90%. Where there is a continuous range of possible outcomes, and each point in that range is as likely as any other, the mid-point of the range is used.
48. Where a single obligation is being measured, the individual most likely outcome may be the best estimate of the liability. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount. For example,

if a government has to rectify a serious fault in a defense vessel that it has constructed for another government, the individual most likely outcome may be for the repair to succeed at the first attempt at a cost of 100,000 currency units, but a provision for a larger amount is made if there is a significant chance that further attempts will be necessary.

49. The provision is measured before tax or tax equivalents. Guidance on dealing with the tax consequences of a provision, and changes in it, is found in IAS 12, "Income Taxes."

#### **Risks and Uncertainties**

50. **The risks and uncertainties that inevitably surround many events and circumstances should be taken into account in reaching the best estimate of a provision.**
51. Risk describes variability of outcome. A risk adjustment may increase the amount at which a liability is measured. Caution is needed in making judgments under conditions of uncertainty, so that revenue or assets are not overstated and expenses or liabilities are not understated. However, uncertainty does not justify the creation of excessive provisions or a deliberate overstatement of liabilities. For example, if the projected costs of a particularly adverse outcome are estimated on a prudent basis, that outcome is not then deliberately treated as more probable than is realistically the case. Care is needed to avoid duplicating adjustments for risk and uncertainty with consequent overstatement of a provision.
52. Disclosure of the uncertainties surrounding the amount of the expenditure is made under paragraph 98(b).

#### **Present Value**

53. **Where the effect of the time value of money is material, the amount of a provision should be the present value of the expenditures expected to be required to settle the obligation.**
54. Because of the time value of money, provisions relating to cash outflows that arise soon after the reporting date are more onerous than those where cash outflows of the same amount arise later. Provisions are therefore discounted, where the effect is material.
55. When a provision is discounted over a number of years, the present value of the provision will increase each year as the provision comes closer to the expected time of settlement (refer to Appendix E). Paragraph 97(e) of this Standard requires disclosure of the increase during the period in the discounted amount arising from the passage of time.
56. **The discount rate (or rates) should be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money and**

**the risks specific to the liability. The discount rate(s) should not reflect risks for which future cash flow estimates have been adjusted.**

57. In some jurisdictions, income taxes or income tax equivalents are levied on a public sector entity's surplus for the period. Where such income taxes are levied on public sector entities, the discount rate selected should be a pre-tax rate.

#### **Future Events**

58. **Future events that may affect the amount required to settle an obligation should be reflected in the amount of a provision where there is sufficient objective evidence that they will occur.**
59. Expected future events may be particularly important in measuring provisions. For example, certain obligations may be index linked to compensate recipients for the effects of inflation or other specific price changes. If there is sufficient evidence of likely expected rates of inflation this should be reflected in the amount of the provision. Another example of future events affecting the amount of a provision is where a government believes that the cost of cleaning up the tar, ash and other pollutants associated with a gasworks' site at the end of its life will be reduced by future changes in technology. In this case, the amount recognized reflects the cost that technically qualified, objective observers reasonably expect to be incurred, taking account of all available evidence as to the technology that will be available at the time of the clean-up. Thus it is appropriate to include, for example, expected cost reductions associated with increased experience in applying existing technology or the expected cost of applying existing technology to a larger or more complex clean-up operation than has previously been carried out. However, an entity does not anticipate the development of a completely new technology for cleaning up unless it is supported by sufficient objective evidence.
60. The effect of possible new legislation which may affect the amount of an existing obligation of a government or an individual public sector entity is taken into consideration in measuring that obligation when sufficient objective evidence exists that the legislation is virtually certain to be enacted. The variety of circumstances that arise in practice makes it impossible to specify a single event that will provide sufficient, objective evidence in every case. Evidence is required both of what legislation will demand and of whether it is virtually certain to be enacted and implemented in due course. In many cases, sufficient objective evidence will not exist until the new legislation is enacted.

#### **Expected Disposal of Assets**

61. **Gains from the expected disposal of assets should not be taken into account in measuring a provision.**

62. Gains on the expected disposal of assets are not taken into account in measuring a provision, even if the expected disposal is closely linked to the event giving rise to the provision. Instead, an entity recognizes gains on expected disposals of assets at the time specified by the International Public Sector Accounting Standard dealing with the assets concerned.

### Reimbursements

63. **Where some or all of the expenditure required to settle a provision is expected to be reimbursed by another party, the reimbursement should be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement should be treated as a separate asset. The amount recognized for the reimbursement should not exceed the amount of the provision.**
64. **In the statement of financial performance, the expense relating to a provision may be presented net of the amount recognized for a reimbursement.**
65. Sometimes, an entity is able to look to another party to pay part or all of the expenditure required to settle a provision (for example, through insurance contracts, indemnity clauses or suppliers' warranties). The other party may either reimburse amounts paid by the entity or pay the amounts directly. For example, a government agency may have legal liability to an individual as a result of misleading advice provided by its employees. However, the agency may be able to recover some of the expenditure from professional indemnity insurance.
66. In most cases, the entity will remain liable for the whole of the amount in question so that the entity would have to settle the full amount if the third party failed to pay for any reason. In this situation, a provision is recognized for the full amount of the liability, and a separate asset for the expected reimbursement is recognized when it is virtually certain that reimbursement will be received if the entity settles the liability.
67. In some cases, the entity will not be liable for the costs in question if the third party fails to pay. In such a case, the entity has no liability for those costs and they are not included in the provision.
68. As noted in paragraph 37, an obligation for which an entity is jointly and severally liable is a contingent liability to the extent that it is expected that the obligation will be settled by the other parties.

## Changes in Provisions

69. **Provisions should be reviewed at each reporting date and adjusted to reflect the current best estimate. If it is no longer probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation, the provision should be reversed.**
70. Where discounting is used, the carrying amount of a provision increases in each period to reflect the passage of time. This increase is recognized as an interest expense.

## Use of Provisions

71. **A provision should be used only for expenditures for which the provision was originally recognized.**
72. Only expenditures that relate to the original provision are set against it. Setting expenditures against a provision that was originally recognized for another purpose would conceal the impact of two different events.

## Application of the Recognition and Measurement Rules

### Future Operating Net Deficits

73. **Provisions should not be recognized for net deficits from future operating activities.**
74. Net deficits from future operating activities do not meet the definition of liabilities in paragraph 18 and the general recognition criteria set out for provisions in paragraph 22.
75. An expectation of net deficits from future operating activities is an indication that certain assets used in these activities may be impaired. An entity tests these assets for impairment. Guidance on accounting for impairment is found in IAS 36, "Impairment of Assets."

### Onerous Contracts

76. **If an entity has a contract that is onerous, the present obligation (net of recoveries) under the contract should be recognized and measured as a provision.**
77. Paragraph 76 of this Standard applies only to contracts that are onerous. Contracts to provide social benefits entered into with the expectation that the entity does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits are excluded from the scope of this Standard.
78. Many contracts evidencing exchange transactions (for example, some routine purchase orders) can be canceled without paying compensation to

the other party, and therefore there is no obligation. Other contracts establish both rights and obligations for each of the contracting parties. Where events make such a contract onerous, the contract falls within the scope of this Standard and a liability exists which is recognized. Executory contracts that are not onerous fall outside the scope of this Standard.

79. This Standard defines an onerous contract as a contract in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it which includes amounts recoverable. Therefore, it is the present obligation net of recoveries that is recognized as a provision under paragraph 76. The unavoidable costs under a contract reflect the least net cost of exiting from the contract, which is the lower of the cost of fulfilling it and any compensation or penalties arising from failure to fulfill it.
80. Before a separate provision for an onerous contract is established, an entity recognizes any impairment loss that has occurred on assets dedicated to that contract.

### Restructuring

81. The following are examples of events that may fall under the definition of restructuring:
- (a) Termination or disposal of an activity or service;
  - (b) The closure of a branch office or termination of activities of a government agency in a specific location or region or the relocation of activities from one region to another;
  - (c) Changes in management structure, for example, eliminating a layer of management or executive service; and
  - (d) Fundamental reorganizations that have a material effect on the nature and focus of the entity's operations.
82. A provision for restructuring costs is recognized only when the general recognition criteria for provisions set out in paragraph 22 are met. Paragraphs 83 to 96 set out how the general recognition criteria apply to restructurings.
83. **A constructive obligation to restructure arises only when an entity:**
- (a) **Has a detailed formal plan for the restructuring identifying at least:**
    - (i) **The activity/operating unit or part of an activity/operating unit concerned;**
    - (ii) **The principal locations affected;**

- (iii) **The location, function, and approximate number of employees who will be compensated for terminating their services;**
    - (iv) **The expenditures that will be undertaken; and**
    - (v) **When the plan will be implemented; and**
  - (b) **Has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.**
- 84. Within the public sector, restructuring may occur at the whole-of-government, portfolio or ministry, or agency level.
- 85. Evidence that a government or an individual entity has started to implement a restructuring plan would be provided, for example, by the public announcement of the main features of the plan, the sale or transfer of assets, notification of intention to cancel leases or the establishment of alternative arrangements for clients of services. A public announcement of a detailed plan to restructure constitutes a constructive obligation to restructure only if it is made in such a way and in sufficient detail (that is, setting out the main features of the plan) that it gives rise to valid expectations in other parties such as users of the service, suppliers and employees (or their representatives) that the government or the entity will carry out the restructuring.
- 86. For a plan to be sufficient to give rise to a constructive obligation when communicated to those affected by it, its implementation needs to be planned to begin as soon as possible and to be completed in a timeframe that makes significant changes to the plan unlikely. If it is expected that there will be a long delay before the restructuring begins or that the restructuring will take an unreasonably long time, it is unlikely that the plan will raise a valid expectation on the part of others that the government or individual entity is at present committed to restructuring, because the timeframe allows opportunities for the government or entity to change its plans.
- 87. A decision by management or the governing body to restructure taken before the reporting date does not give rise to a constructive obligation at the reporting date unless the entity has, before the reporting date:
  - (a) Started to implement the restructuring plan; or
  - (b) Announced the main features of the restructuring plan to those affected by it in a sufficiently specific manner to raise a valid expectation in them that the entity will carry out the restructuring.

If an entity starts to implement a restructuring plan, or announces its main features to those affected, only after the reporting date, disclosure may be required under IPSAS 14, “Events after the Reporting Date,” if the

restructuring is material and non-disclosure could influence the economic decisions of users taken on the financial statements.

88. Although a constructive obligation is not created solely by a management or governing body decision, an obligation may result from other earlier events together with such a decision. For example, negotiations with employee representatives for termination payments, or with purchasers for the sale or transfer of an operation, may have been concluded subject only to governing body or board approval. Once that approval has been obtained and communicated to the other parties, the entity has a constructive obligation to restructure, if the conditions of paragraph 83 are met.
89. In some countries, the ultimate authority for making decisions about a public sector entity is vested in a governing body or board whose membership includes representatives of interests other than those of management (for example, employees) or notification to these representatives may be necessary before the governing body or board decision is taken. Because a decision by such a governing body or board involves communication to these representatives, it may result in a constructive obligation to restructure.

*Sale or Transfer of Operations*

90. **No obligation arises as a consequence of the sale or transfer of an operation until the entity is committed to the sale or transfer, that is, there is a binding agreement.**
91. Even when an entity has taken a decision to sell an operation and announced that decision publicly, it cannot be committed to the sale until a purchaser has been identified and there is a binding sale agreement. Until there is a binding sale agreement, the entity will be able to change its mind and indeed will have to take another course of action if a purchaser cannot be found on acceptable terms. When a sale is only part of a restructuring, a constructive obligation can arise for the other parts of the restructuring before a binding sale agreement exists.
92. Restructuring within the public sector often involves the transfer of operations from one controlled entity to another and may involve the transfer of operations at no or nominal consideration. Such transfers will often take place under a government directive and will not involve binding agreements as described in paragraph 90. An obligation exists only when there is a binding transfer agreement. Even where proposed transfers do not lead to the recognition of a provision, the planned transaction may require disclosure under other International Public Sector Accounting Standards or proposed Standards such as the IPSAS 14, “Events after the Reporting Date” and IPSAS 20, “Related Party Disclosures.”

*Restructuring Provisions*

93. **A restructuring provision should include only the direct expenditures arising from the restructuring, which are those that are both:**
- (a) **Necessarily entailed by the restructuring; and**
  - (b) **Not associated with the ongoing activities of the entity.**
94. A restructuring provision does not include such costs as:
- (a) Retraining or relocating continuing staff;
  - (b) Marketing; or
  - (c) Investment in new systems and distribution networks.
- These expenditures relate to the future conduct of an activity and are not liabilities for restructuring at the reporting date. Such expenditures are recognized on the same basis as if they arose independently of a restructuring.
95. Identifiable future operating net deficits up to the date of a restructuring are not included in a provision, unless they relate to an onerous contract as defined in paragraph 18.
96. As required by paragraph 61, gains on the expected disposal of assets are not taken into account in measuring a restructuring provision, even if the sale of assets is envisaged as part of the restructuring.

**Disclosure**

97. **For each class of provision, an entity should disclose:**
- (a) **The carrying amount at the beginning and end of the period;**
  - (b) **Additional provisions made in the period, including increases to existing provisions;**
  - (c) **Amounts used (that is, incurred and charged against the provision) during the period;**
  - (d) **Unused amounts reversed during the period; and**
  - (e) **The increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.**

**Comparative information is not required.**

98. **An entity should disclose the following for each class of provision:**
- (a) **A brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits or service potential;**

- (b) **An indication of the uncertainties about the amount or timing of those outflows. Where necessary to provide adequate information, an entity should disclose the major assumptions made concerning future events, as addressed in paragraph 58; and**
  - (c) **The amount of any expected reimbursement, stating the amount of any asset that has been recognized for that expected reimbursement.**
- 99. **Where an entity elects to recognize in its financial statements provisions for social benefits for which it does not receive consideration that is approximately equal to the value of goods and services provided, directly in return from the recipients of those benefits, it should make the disclosures required in paragraphs 97 and 98 in respect of those provisions.**
- 100. **Unless the possibility of any outflow in settlement is remote, an entity should disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, where practicable:**
  - (a) **An estimate of its financial effect, measured under paragraphs 44 to 62;**
  - (b) **An indication of the uncertainties relating to the amount or timing of any outflow; and**
  - (c) **The possibility of any reimbursement.**
- 101. In determining which provisions or contingent liabilities may be aggregated to form a class, it is necessary to consider whether the nature of the items is sufficiently similar for a single statement about them to fulfill the requirements of paragraphs 98(a) and (b) and 100(a) and (b). Thus, it may be appropriate to treat as a single class of provision amounts relating to one type of obligation, but it would not be appropriate to treat as a single class amounts relating to environmental restoration costs and amounts that are subject to legal proceedings.
- 102. Where a provision and a contingent liability arise from the same set of circumstances, an entity makes the disclosures required by paragraphs 97, 98 and 100 in a way that shows the link between the provision and the contingent liability.
- 103. An entity may in certain circumstances use external valuation to measure a provision. In such cases, information relating to the valuation can usefully be disclosed.
- 104. The disclosure requirements in paragraph 100 do not apply to contingent liabilities that arise from social benefits provided by an entity for which it

does not receive consideration that is approximately equal to the value of goods or services provided, directly in return from the recipients of those benefits (see paragraphs 1(a) and 7–11 for a discussion of the exclusion of social benefits from this Standard).

105. **Where an inflow of economic benefits or service potential is probable, an entity should disclose a brief description of the nature of the contingent assets at the reporting date, and, where practicable, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 44 to 62.**
106. The disclosure requirements in paragraph 105 are only intended to apply to those contingent assets where there is a reasonable expectation that benefits will flow to the entity. That is, there is no requirement to disclose this information about all contingent assets (see paragraphs 39 to 43 for a discussion of contingent assets). It is important that disclosures for contingent assets avoid giving misleading indications of the likelihood of revenue arising. For example, a contingent asset would arise from a contract where a public sector entity allows a private sector company to mine one of its properties in exchange for a royalty based on a set price per ton extracted and the company has commenced mining. In addition to disclosing the nature of the arrangement, the contingent asset should be quantified where a reasonable estimate can be made of the quantity of mineral to be extracted and the timing of the expected cash inflows. If there were no proven reserves or some other circumstances prevailed that indicated that it would be unlikely that any minerals would be extracted, the public sector entity would not disclose information required by paragraph 105 as there is no probable flow of benefits.
107. The disclosure requirements in paragraph 105 encompass contingent assets from both exchange and non-exchange transactions. Whether a contingent asset exists in relation to taxation revenues rests on the interpretation of what constitutes a taxable event. The determination of the taxable event for taxation revenue and its possible implications for the disclosure of contingent assets related to taxation revenues are to be dealt with as a part of a separate project on non-exchange revenue.
108. **Where any of the information required by paragraphs 100 and 105 is not disclosed because it is not practicable to do so, that fact should be stated.**
109. **In extremely rare cases, disclosure of some or all of the information required by paragraphs 97 to 107 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but should**

**disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.**

### **Transitional Provisions**

110. **The effect of adopting this Standard on its effective date (or earlier) should be reported as an adjustment to the opening balance of accumulated surpluses/(deficits) for the period in which the Standard is first adopted. Entities are encouraged, but not required, to adjust the opening balance of accumulated surpluses/(deficits) for the earliest period presented and to restate comparative information. If comparative information is not restated, this fact should be disclosed.**

### **Effective Date**

111. **This International Public Sector Accounting Standard becomes effective for annual financial statements covering periods beginning on or after January 1, 2004. Earlier application is encouraged.**
112. When an entity adopts the accrual basis of accounting, as defined by International Public Sector Accounting Standards, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

## Appendix A

### Tables—Provisions, Contingent Liabilities, Contingent Assets and Reimbursements

*The purpose of this appendix is to summarize the main requirements of the standards. It does not form part of the standards and should be read in the context of the full text of the standards.*

#### *Provisions and Contingent Liabilities*

<p><b>Where, as a result of past events, there may be an outflow of resources embodying future economic benefits or service potential in settlement of: (a) a present obligation; or (b) a possible obligation whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.</b></p>		
<p><b>There is a present obligation that probably requires an outflow of resources.</b></p>	<p><b>There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.</b></p>	<p><b>There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.</b></p>
<p>A provision is recognized (paragraph 22).  Disclosures are required for the provision (paragraphs 97 and 98).</p>	<p>No provision is recognized (paragraph 35).  Disclosures are required for the contingent liability (paragraph 100).</p>	<p>No provision is recognized (paragraph 35).  No disclosure is required (paragraph 100).</p>

A contingent liability also arises in the extremely rare case where there is a liability that cannot be recognized because it cannot be measured reliably. Disclosures are required for the contingent liability.

*Contingent Assets*

<b>Where, as a result of past events, there is a possible asset whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.</b>		
<b>The inflow of economic benefits or service potential is virtually certain.</b>	<b>The inflow of economic benefits or service potential is probable, but not virtually certain.</b>	<b>The inflow of economic benefits or service potential is not probable.</b>
The asset is not contingent (paragraph 41).	No asset is recognized (paragraph 39).	No asset is recognized (paragraph 39).
	Disclosures are required (paragraph 105).	No disclosure is required (paragraph 105).

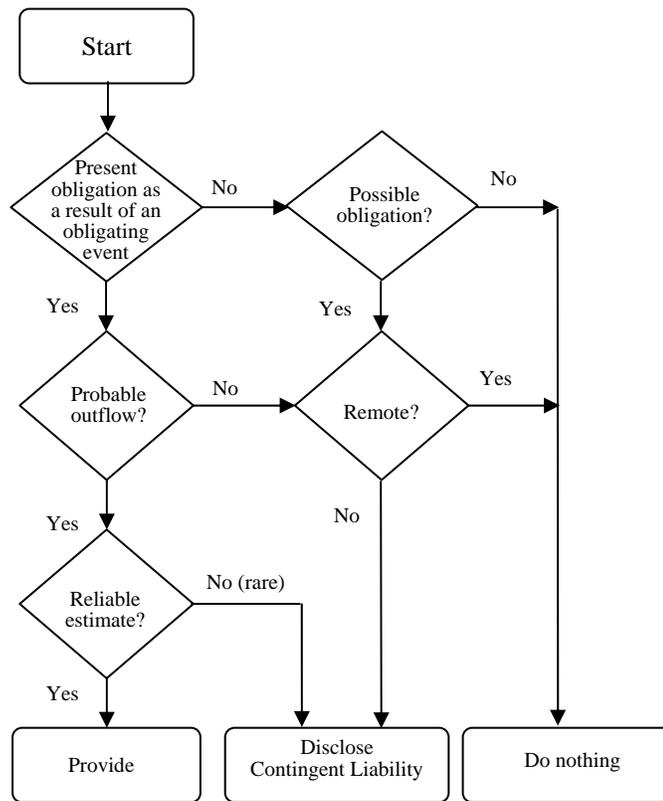
PROVISIONS, CONTINGENT LIABILITIES  
AND CONTINGENT ASSETS

*Reimbursements*

<b>Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.</b>		
<b>The entity has no obligation for the part of the expenditure to be reimbursed by the other party.</b>	<b>The obligation for the amount expected to be reimbursed remains with the entity and it is virtually certain that reimbursement will be received if the entity settles the provision.</b>	<b>The obligation for the amount expected to be reimbursed remains with the entity and the reimbursement is not virtually certain if the entity settles the provision.</b>
The entity has no liability for the amount to be reimbursed (paragraph 67).	The reimbursement is recognized as a separate asset in the statement of financial position and may be offset against the expense in the statement of financial performance. The amount recognized for the expected reimbursement does not exceed the liability (paragraphs 63 and 64).	The expected reimbursement is not recognized as an asset (paragraph 63).
No disclosure is required.	The reimbursement is disclosed together with the amount recognized for the reimbursement (paragraph 98(c)).	The expected reimbursement is disclosed (paragraph 98(c)).

**Decision Tree**

*The purpose of the decision tree is to summarize the main recognition requirements of the standards for provisions and contingent liabilities that fall within the scope of the Standard. The decision tree does not form part of the standards and should be read in the context of the full text of the standards. Note: in some cases, it is not clear whether there is a present obligation. In these cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is more likely than not that a present obligation exists at the reporting date (paragraph 23 of the Standard).*



## Appendix C

### Examples: Recognition

*This appendix illustrates the application of the standards to assist in clarifying their meaning. It does not form part of the standards.*

*All the entities in the examples have a reporting date of December 31. In all cases, it is assumed that a reliable estimate can be made of any outflows expected. In some examples the circumstances described may have resulted in impairment of the assets — this aspect is not dealt with in the examples.*

*The cross-references provided in the examples indicate paragraphs of the Standard that are particularly relevant. The appendix should be read in the context of the full text of the standards.*

*References to “best estimate” are to the present value amount, where the effect of the time value of money is material.*

#### *Example 1: Warranties*

Government Department A manufactures search and rescue equipment for use within the Government and for sale to the public. At the time of sale the Department gives warranties to purchasers in relation to certain products. Under the terms of the sale the Department undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (that is, more likely than not) that there will be some claims under the warranties.

#### *Analysis*

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

**An outflow of resources embodying economic benefits or service potential in settlement**—Probable for the warranties as a whole (see paragraph 32).

**Conclusion**—A provision is recognized for the best estimate of the costs of making good under the warranty products sold on or before the reporting date (see paragraphs 22 and 32).

#### *Example 2A: Contaminated Land—Legislation Virtually Certain to be Enacted*

A provincial government owns a warehouse on land near a port. The provincial government has retained ownership of the land because it may require the land for future expansion of its port operations. For the past ten years a group of farmers have leased the property as a storage facility for agricultural chemicals. The national government announces its intention to enact environmental legislation requiring property owners to accept liability for environmental pollution, including the cost of

cleaning-up contaminated land. As a result, the provincial government introduces a hazardous chemical policy and begins applying the policy to its activities and properties. At this stage it becomes apparent that the agricultural chemicals have contaminated the land surrounding the warehouse. The provincial government has no recourse against the farmers or its insurance company for the clean-up costs. At December 31, 2001 it is virtually certain that a draft law requiring a clean-up of land already contaminated will be enacted shortly after the year end.

*Analysis*

**Present obligation as a result of a past obligating event**—The obligating event is the contamination of the land because of the virtual certainty of legislation requiring the clean-up.

**An outflow of resources embodying economic benefits or service potential in settlement**<sup>1</sup>—Probable.

**Conclusion**—A provision is recognized for the best estimate of the costs of the clean-up (see paragraphs 22 and 30).

*Example 2B: Contamination and Constructive Obligation*

A government has a widely published environmental policy in which it undertakes to clean up all contamination that it causes. The government has a record of honoring this published policy. There is no environmental legislation in place in the jurisdiction. During the course of a naval exercise a vessel is damaged and leaks a substantial amount of oil. The government agrees to pay for the costs of the immediate clean-up and the ongoing costs of monitoring and assisting marine animals and birds.

*Analysis*

**Present obligation as a result of a past obligating event**—The obligating event is the contamination of the environment, which gives rise to a constructive obligation because the policy and previous conduct of the government has created a valid expectation that the government will clean up the contamination.

**An outflow of resources embodying economic benefits or service potential in settlement**—Probable.

**Conclusion**—A provision is recognized for the best estimate of the costs of the clean-up (see paragraphs 22 and 30).

*Example 3: Gravel Quarry*

A government operates a gravel quarry on land that it leases on a commercial basis from a private sector company. The gravel is used for the construction and maintenance of roads. The agreement with the landowners requires the government to restore the quarry site by removing all buildings, reshaping the land and replacing all topsoil. 60% of the eventual restoration costs relate to the removal of the quarry

buildings and restoration of the site, and 40% arise through the extraction of gravel. At the reporting date, the quarry buildings have been constructed and excavation of the site has begun but no gravel has been extracted.

*Analysis*

**Present obligation as a result of a past obligating event**—The construction of buildings and the excavation of the quarry creates a legal obligation under the terms of the agreement to remove the buildings and restore the site and is thus an obligating event. At the reporting date, however, there is no obligation to rectify the damage that will be caused by extraction of the gravel.

**An outflow of resources embodying economic benefits or service potential in settlement**—Probable.

**Conclusion**—A provision is recognized for the best estimate of 60% of the eventual costs that relate to the removal of the buildings and restoration of the site (see paragraph 22). These costs are included as part of the cost of the quarry. The 40% of costs that arise through the extraction of gravel are recognized as a liability progressively when the gravel is extracted.

*Example 4: Refunds Policy*

A government stores agency operates as a centralized purchasing agency and allows the public to purchase surplus supplies. It has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

*Analysis*

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

**An outflow of resources embodying economic benefits or service potential in settlement**—Probable that a proportion of goods are returned for refund (see paragraph 32).

**Conclusion**—A provision is recognized for the best estimate of the costs of refunds (see paragraphs 18 (the definition of a constructive obligation), 22, 25 and 32).

*Example 5A: Closure of a Division—No Implementation before Reporting Date*

On 12 December 2004 a government decides to close down a division of a government agency. The decision was not communicated to any of those affected before the reporting date (December 31, 2004) and no other steps were taken to implement the decision.

*Analysis*

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

**Conclusion**—No provision is recognized (see paragraphs 22 and 83).

*Example 5B: Outsourcing of a Division—Implementation Before the Reporting Date*

On December 12, 2004, a government decided to outsource a division of a government department. On December 20, 2004 a detailed plan for outsourcing the division was agreed by the government, and redundancy notices were sent to the staff of the division.

*Analysis*

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

**An outflow of resources embodying economic benefits or service potential in settlement**—Probable.

**Conclusion**—A provision is recognized at December 31, 2004 for the best estimate of the costs of outsourcing the division (see paragraphs 22 and 83).

*Example 6: Legal Requirement to Fit Air Filters*

Under new legislation, a local government entity is required to fit new air filters to its public buildings by 30 June 2005. The entity has not fitted the air filters.

*Analysis*

(a) At the reporting date of December 31, 2004

**Present obligation as a result of a past obligating event**—There is no obligation because there is no obligating event either for the costs of fitting air filters or for fines under the legislation.

**Conclusion**—No provision is recognized for the cost of fitting the filters (see paragraphs 22 and 25–27).

(b) At the reporting date of December 31, 2005

**Present obligation as a result of a past obligating event**—There is still no obligation for the costs of fitting air filters because no obligating event has occurred (the fitting of the filters). However, an obligation might arise to pay fines or penalties under the legislation because the obligating event has occurred (the non-compliance of the public buildings).

**An outflow of resources embodying economic benefits or service potential in settlement**—Assessment of probability of incurring fines and penalties for non-compliance depends on the details of the legislation and the stringency of the enforcement regime.

**Conclusion**—No provision is recognized for the costs of fitting air filters. However, a provision is recognized for the best estimate of any fines and penalties that are more likely than not to be imposed (see paragraphs 22 and 25–27).

*Example 7: Staff Retraining as a Result of Changes in the Income Tax System*

The government introduces a number of changes to the income tax system. As a result of these changes, the taxation department (reporting entity) will need to retrain a large proportion of its administrative and compliance staff in order to ensure continued compliance with financial services regulation. At the reporting date, no retraining of staff has taken place.

*Analysis*

**Present obligation as a result of a past obligating event**—There is no obligation because no obligating event (retraining) has taken place.

**Conclusion**—No provision is recognized (see paragraphs 22 and 25–27).

*Example 8: An Onerous Contract*

A hospital laundry operates from a building that the hospital (the reporting entity) has leased under an operating lease. During December 2004 the laundry relocates to a new building. The lease on the old building continues for the next four years: it cannot be canceled. The hospital has no alternative use for the building and the building cannot be re-let to another user.

*Analysis*

**Present obligation as a result of a past obligating event**—The obligating event is the signing of the lease contract, which gives rise to a legal obligation.

**An outflow of resources embodying economic benefits or service potential in settlement**—When the lease becomes onerous, an outflow of resources embodying economic benefits is probable. (Until the lease becomes onerous, the hospital accounts for the lease under IPSAS 13, “Leases”).

**Conclusion**—A provision is recognized for the best estimate of the unavoidable lease payments (see paragraphs 13(b), 22 and 76).

*Example 9: A Single Guarantee*

During 2004, a provincial government gives a guarantee of certain borrowings of a private sector operator providing public services for a fee, whose financial condition

at that time is sound. During 2005, the financial condition of the operator deteriorates and at June 30, 2005 the operator files for protection from its creditors.

*Analysis*

(a) At December 31, 2004

**Present obligation as a result of a past obligating event**—The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

**An outflow of resources embodying economic benefits or service potential in settlement**—No outflow of benefits is probable at December 31, 2004.

**Conclusion**—No provision is recognized (see paragraphs 22 and 31). The guarantee is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (see paragraphs 100 and 109).

(b) At December 31, 2005

**Present obligation as a result of a past obligating event**—The obligating event is the giving of the guarantee, which gives rise to a legal obligation.

**An outflow of resources embodying economic benefits or service potential in settlement**—At December 31, 2005, it is probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation.

**Conclusion**—A provision is recognized for the best estimate of the obligation (see paragraphs 22, 31 and 109).

Note: This example deals with a single guarantee. If an entity has a portfolio of similar guarantees, it will assess that portfolio as a whole in determining whether an outflow of resources embodying economic benefits or service potential is probable (see paragraph 32). Where an entity gives guarantees in exchange for a fee, revenue is recognized under IPSAS 9, “Revenue from Exchange Transactions.”

*Example 10: A Court Case*

After a luncheon in 2004, ten people died, possibly as a result of food poisoning from products sold by a restaurant at a public museum (the reporting entity). Legal proceedings are started seeking damages from the entity but it disputes liability. Up to the date of authorization of the financial statements for the year to December 31, 2004 for issue, the entity’s lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to December 31, 2005, its lawyers advise that, owing to developments in the case, it is probable that the entity will be found liable.

*Analysis*

(a) At December 31, 2004

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

**Conclusion**—No provision is recognized by the museum (see paragraphs 23 and 24). The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote (paragraphs 100 and 109).

(b) At December 31, 2005

**Present obligation as a result of a past obligating event**—On the basis of the evidence available, there is a present obligation.

**An outflow of resources embodying economic benefits or service potential in settlement**—Probable.

**Conclusion**—A provision is recognized for the best estimate of the amount to settle the obligation (paragraphs 22–24 and 109).

*Example 11: Repairs and Maintenance*

Some assets require, in addition to routine maintenance, substantial expenditure every few years for major refits or refurbishment and the replacement of major components. IPSAS 17, “Property, Plant and Equipment,” gives guidance on allocating expenditure on an asset to its component parts where these components have different useful lives or provide benefits in a different pattern.

*Example 11A: Refurbishment Costs – No Legislative Requirement*

A furnace for heating a building that is leased out by a government department to a number of public sector tenants has a lining that needs to be replaced every five years for technical reasons. At the reporting date, the lining has been in use for three years.

*Analysis*

**Present obligation as a result of a past obligating event**—There is no present obligation.

**Conclusion**—No provision is recognized (see paragraphs 22 and 25–27).

The cost of replacing the lining is not recognized because, at the reporting date, no obligation to replace the lining exists independently of the entity’s future actions — even the intention to incur the expenditure depends on the entity deciding to continue operating the furnace or to replace the lining. Instead of a provision being recognized, the depreciation of the lining takes account of its consumption, that is, it is depreciated over five years. The re-lining costs then incurred are capitalized with the consumption of each new lining shown by depreciation over the subsequent five years.

*Example 11B: Refurbishment Costs—Legislative Requirement*

A government cartography service is required by law to overhaul its aircraft used for aerial mapping once every three years.

*Analysis*

Present obligation as a result of a past obligating event—There is no present obligation.

Conclusion—No provision is recognized (see paragraphs 22 and 25–27).

The costs of overhauling aircraft are not recognized as a provision for the same reasons as the cost of replacing the lining is not recognized as a provision in Example 11A. Even a legal requirement to overhaul does not make the costs of overhaul a liability, because no obligation exists to overhaul the aircraft independently of the entity's future actions—the entity could avoid the future expenditure by its future actions, for example by selling the aircraft.

## Appendix D

### Examples: Disclosures

*The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.*

*Two examples of the disclosures required by paragraph 98 are provided below and on the following page.*

#### **Example 1: Warranties**

A government department with responsibility for the prevention of workplace accidents gives warranties at the time of sale to purchasers of its safety products. Under the terms of the warranty, the department undertakes to repair or replace items that fail to perform satisfactorily for two years from the date of sale. At the reporting date, a provision of 60,000 currency units has been recognized. The provision has not been discounted as the effect of discounting is not material. The following information is disclosed:

*A provision of 60,000 currency units has been recognized for expected warranty claims on products sold during the last three financial years. It is expected that the majority of this expenditure will be incurred in the next financial year, and all will be incurred within two years of the reporting date.*

#### **Example 2: Decommissioning Costs**

In 2005, a state-owned research facility, which uses a nuclear reactor to develop radio isotopes that are used for medical purposes, recognizes a provision for decommissioning costs of 300 million currency units. The provision is estimated using the assumption that decommissioning will take place in 60–70 years' time. However, there is a possibility that it will not take place until 100–110 years' time, in which case the present value of the costs will be significantly reduced. The following information is disclosed:

*A provision of 300 million currency units has been recognized for decommissioning costs. These costs are expected to be incurred between 2065 and 2075; however, there is a possibility that decommissioning will not take place until 2105–2115. If the costs were measured based upon the expectation that they would not be incurred until 2105–2115 the provision would be reduced to 136 million. The provision has been estimated using existing technology, at current prices, and discounted using a real discount rate of 2%.*

*An example is given below of the disclosures required by paragraph 109 where some of the information required is not given because it can be expected to prejudice seriously the position of the entity.*

**Example 3: Disclosure Exemption**

A government research agency is involved in a dispute with a company, which is alleging that the research agency has infringed copyright in its use of genetic material and is seeking damages of 100 million currency units. The research agency recognizes a provision for its best estimate of the obligation, but discloses none of the information required by paragraphs 97 and 98 of the Standard. The following information is disclosed:

*Litigation is in process against the agency relating to a dispute with a company that alleges that the agency has infringed patents and is seeking damages of 100 million currency units. The information usually required by IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets,” is not disclosed on the grounds that it can be expected to prejudice seriously the outcome of the litigation. The board is of the opinion that the claim can be successfully defended by the agency.*

## Appendix E

### **Example: Present Value of a Provision**

*The appendix is illustrative only and does not form part of the standards. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.*

*The following example illustrates the journal entries made on initial recognition of the present value of a provision and the subsequent recognition of increases in the present value of that provision. The increase in the provision is recognized as an interest expense (paragraph 70).*

The expected value of a provision at the end of year 5 is 2000 currency units. This expected value has not been risk adjusted. An appropriate discount rate which takes account of the risk associated with this cash flow has been estimated at 12%.

PROVISIONS, CONTINGENT LIABILITIES  
AND CONTINGENT ASSETS

Journal entries to record the provision and changes in the value of the provision each year are as follows:

End of current reporting period

DR	Expense	1134.85	
CR	Provision		1134.85

End of Year 1

DR	Interest Expense	136.18	
CR	Provision		136.18

End of Year 2

DR	Interest Expense	152.52	
CR	Provision		152.52

End of Year 3

DR	Interest Expense	170.83	
CR	Provision		170.83

End of Year 4

DR	Interest Expense	191.33	
CR	Provision		191.33

End of Year 5

DR	Interest Expense	214.29	
CR	Provision		214.29

	Calculations:	Increase
Current time:	Present value = $2000/(1.12)^5 = 1134.85$	
End of Year 1:	Present value = $2000/(1.12)^4 = 1271.04$	136.18
End of Year 2:	Present value = $2000/(1.12)^3 = 1423.56$	152.52
End of Year 3:	Present value = $2000/(1.12)^2 = 1594.39$	170.83
End of Year 4:	Present value = $2000/(1.12)^1 = 1785.71$	191.33
End of Year 5:	Present value = $2000/(1.12)^0 = 2000.00$	214.29

### **Comparison with IAS 37**

IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets” is drawn primarily from IAS 37, “Provisions, Contingent Liabilities and Contingent Assets” (1998). The main differences between IPSAS 19 and IAS 37 are as follows:

- IPSAS 19 includes commentary additional to that in IAS 37 to clarify the applicability of the standards to accounting by public sector entities. In particular, the scope of IPSAS 19 clarifies that it does not apply to provisions and contingent liabilities arising from social benefits provided by an entity for which it does not receive consideration that is approximately equal to the value of the goods and services provided directly in return from recipients of those benefits. However, if the entity elects to recognize provisions for social benefits, IPSAS 19 requires certain disclosures in this respect.
- Black letter in IAS 37 has been modified and commentary additional to that in IAS 37 has been included in IPSAS 19 to clarify that, in the case of onerous contracts, it is the present obligation net of recoveries that is recognized as a provision.
- The scope paragraph in IPSAS 19 makes it clear that while provisions, contingent liabilities and contingent assets arising from employee benefits are excluded from the scope of the Standard, the Standard, however, applies to provisions, contingent liabilities and contingent assets arising from termination benefits that result from a restructuring dealt with in the Standard.
- IPSAS 19 uses different terminology, in certain instances, from IAS 37. The most significant examples are the use of the terms entity, revenue, “statement of financial performance, and statement of financial position in IPSAS 19. The equivalent terms in IAS 37 are enterprise, income, income statement, and balance sheet.
- IPSAS 19 contains the definitions of technical terms used in IAS 37 and an additional definition for “executory contracts.”
- The Appendix C examples have been amended to be more reflective of the public sector.
- IPSAS 19 contains an additional appendix (Appendix E) which illustrates the journal entries for recognition of the change in the value of a provision over time, due to the impact of the discount factor.