International Public Sector Accounting Standards Board®

Handbook of International Public Sector Accounting Pronouncements

2016 Edition
Volume I

IPSAS®

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This publication was published by the International Federation of Accountants (IFAC®). Its mission is to serve the public interest and strengthen the accountancy profession by supporting the development of high-quality international standards, promoting the adoption and implementation of these standards, building the capacity of professional accountancy organizations, and speaking out on public interest issues.

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INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

IPSAS™

HANDBOOK OF INTERNATIONAL PUBLIC SECTOR ACCOUNTING PRONOUNCEMENTS

2016 EDITION

How this Handbook is Arranged

The contents of this Handbook are arranged by section as follows:

INTRODUCTION TO THE INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS BOARD

The International Public Sector Accounting Standards Board® (IPSASB®) develops accounting standards for public sector entities referred to as International Public Sector Accounting Standards™ (IPSAS™). 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 and Consultation Papers.

The IPSASB issues IPSASs dealing with financial reporting under the cash basis of accounting and the accrual basis of accounting. The accrual 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.

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THE INTERNATIONAL FEDERATION OF ACCOUNTANTS' ROLE

The International Federation of Accountants® (IFAC®) serves the public interest by contributing to the development of strong and sustainable organizations, markets, and economies. It advocates for transparency, accountability, and comparability of financial reporting; helps develop the accountancy profession; and communicates the importance and value of accountants to the global financial infrastructure. Founded in 1977, IFAC is currently comprised of over 175 members and associates in more than 130 countries and jurisdictions, representing almost 3 million accountants in public practice, education, government service, industry, and commerce.

As part of its public interest mandate, IFAC contributes to the development, adoption, and implementation of high-quality international public sector accounting standards, primarily through its support of the International Public Sector Accounting Standards Board (IPSASB). IFAC provides human resources, facilities management, communications support, and funding to this independent standard-setting board, and facilitates the nominations and selection process for board members.

The IPSASB sets its own agendas and approves its publications in accordance with its due process and without IFAC's involvement. IFAC has no ability to influence the agendas or publications. IFAC publishes the handbooks, standards, and other publications and owns the copyrights.

The IPSASB's independence is safeguarded in a number of ways:

- Full transparency, both in terms of due process for standard-setting, as well as public access to agenda materials, meetings, and a published basis for conclusions with each final standard;
- The involvement of observers in the standard-setting process; and
- The requirement that IPSASB members, as well as nominating/employing organizations, commit to the board's independence, integrity, and public interest mission.

The IPSASB Consultative Advisory Group (CAG) is an integral and important part of the IPSASB's formal process of consultation. Representatives of CAG member organizations provide advice on numerous areas, including:

- The IPSASB's strategy, work program and agenda, including project priorities;
- IPSASB's projects, including views on key technical issues or matters that may impede the adoption or effective implementation of IPSAS; and
- Other matters of relevance to the standard-setting activities of the IPSASB.

The governance and standard-setting activities of the IPSASB are overseen by the Public Interest Committee (PIC), to ensure that they follow due process and reflect the public interest.

The PIC is comprised of individuals with expertise in public sector or financial reporting, and professional engagement in organizations that have an interest in promoting high-quality and internationally comparable financial information.

Visit the IFAC website at www.ifac.org for further information.

SCOPE OF THIS HANDBOOK

2016 EDITION

This Handbook brings together for continuing reference background information about the International Federation of Accountants (IFAC) and the official text of the International Public Sector Accounting Standards (IPSASs) and other publications issued by the IPSASB as of January 31, 2016.

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CHANGES OF SUBSTANCE FROM THE 2015 EDITION OF THE HANDBOOK

Pronouncements Issued by the International Public Sector Accounting Standards Board

This Handbook contains the complete set of the International Public Sector Accounting Standards Board's (IPSASB's) pronouncements on public sector financial reporting.

References

This Handbook contains references to International Accounting Standards (IASs) and International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB). The approved text of the IASs and the IFRSs is that published by the IASB in the English language, and copies may be obtained directly from IFRS Publications Department, First Floor, 30 Cannon Street, London EC4M 6XH, United Kingdom.

E-mail: publications@ifrs.org

Internet: www.ifrs.org

Recommended Practice Guideline 3, *Reporting Service Performance Information*

Recommended Practice Guideline (RPG) 3, *Reporting Service Performance Information*, provides good practice guidelines on reporting service performance information.

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PREFACE TO INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARDS

History of the Preface

The *Preface* was issued in 2000.

In November 2004 the IPSASB issued a revised *Preface*.

In December 2006 the IPSASB amended the *Preface*.

In March 2012 the IPSASB issued a revised *Preface*.

March 2012

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 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 Consultation Papers, other discussion documents, Exposure Drafts, Recommended Practice Guidelines and Standards developed and issued 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 by contributing to the development, adoption and implementation of high-quality international standards and guidance; contributing to the development of strong professional accountancy organizations and accounting firms, and to high quality practices by professional accountants; promoting the value of professional accountants worldwide; and speaking out on public interest issues where the accountancy profession's expertise is most relevant." In pursuing this mission, the IFAC Board has established the IPSASB to function as an independent standard-setting body under the auspices of IFAC.

3. The IPSASB serves the public interest by developing and issuing, under its own authority, accounting standards and other publications for use by public sector entities other than Government Business Enterprises (GBEs).

4. Information on the IPSASB's membership, terms of office, meeting procedures and due process is set out in the IPSASB's *Terms of Reference*, which are approved by the IFAC Board.

Objective of the IPSASB

5. The objective of the IPSASB is to serve the public interest by developing high-quality accounting standards and other publications for use by public sector entities around the world in the preparation of general purpose financial reports.

6. This is intended to enhance the quality and transparency of public sector financial reporting by providing better information for public sector financial management and decision making. In pursuit of this objective, the IPSASB supports the convergence of international and national public sector accounting standards and the convergence of accounting and statistical bases of financial reporting where appropriate; and also promotes the acceptance of its standards and other publications.

7. In fulfilling its objective, the IPSASB develops and issues the following publications:

   - IPSASs as the standards to be applied in the preparation of general purpose financial reports of public sector entities other than GBEs.
   - Recommended Practice Guidelines (RPGs) to provide guidance on good practice that public sector entities are encouraged to follow.
   - Studies to provide advice on financial reporting issues in the public sector. They are based on study of the good practices and most effective methods for dealing with the issues being addressed.
   - Other 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.

Scope and Authority of International Public Sector Accounting Standards

Scope of the Standards

8. The IPSASB develops IPSASs which apply to the accrual basis of accounting and IPSASs which apply to the cash basis of accounting.

9. IPSASs set out requirements dealing with transactions and other events in general purpose financial reports. General purpose financial reports are financial reports intended to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information needs.

10. The IPSASs are designed to apply to the general purpose financial reports of all public sector entities other than GBEs. Public sector entities include 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), unless otherwise stated. International organizations also apply IPSASs. The IPSASs 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.

11. Any limitation of the applicability of specific IPSASs is made clear in those standards. IPSASs are not meant to apply to immaterial items.

12. 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. 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*.

IPSASs for the Accrual and Cash Bases

13. The IPSASB develops accrual IPSASs that:

- Are converged with International Financial Reporting Standards (IFRSs) issued by the IASB by adapting them to a public sector context where 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 addressed by adapting IFRSs or for which IFRSs have not been developed by the IASB.

14. [deleted]

15. 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

16. 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.

17. 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. 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 reports in full accordance with all accrual based IPSASs.

18. Paragraph 28 of IPSAS 1, *Presentation of Financial Statements* includes the following requirement:

> 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.

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

Authority of the International Public Sector Accounting Standards

20. Within each jurisdiction, regulations may govern the issue of general purpose financial reports 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.

21. 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 strengthen public finance management leading to better informed assessments of the resource allocation decisions made by governments, thereby increasing transparency and accountability.

22. The IPSASB strongly encourages the adoption of IPSASs and the harmonization of national requirements with IPSASs. 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.

23. 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.

Language

24. The official text of the IPSASs and other publications is that approved 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 jurisdictions as appropriate.

THE CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES

History of the Conceptual Framework

Chapters 1–4 of the *Conceptual Framework* were issued in January 2013.

The preface and chapters 5–8 of the *Conceptual Framework* were issued in October 2014.

THE CONCEPTUAL FRAMEWORK FOR GENERAL PURPOSE FINANCIAL REPORTING BY PUBLIC SECTOR ENTITIES

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The Preface to the Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities

Introduction

1. The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities (the Conceptual Framework) establishes the concepts that are to be applied in developing International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs) applicable to the preparation and presentation of general purpose financial reports (GPFRs) of public sector entities[1].

2. The primary objective of most public sector entities is to deliver services to the public, rather than to make profits and generate a return on equity to investors. Consequently the performance of such entities can be only partially evaluated by examination of financial position, financial performance and cash flows. GPFRs provide information to users for accountability and decision-making purposes. Therefore, users of the GPFRs of public sector entities need information to support assessments of such matters as:

   - Whether the entity provided its services to constituents in an efficient and effective manner;
   - The resources currently available for future expenditures, and to what extent there are restrictions or conditions attached to their use;
   - To what extent the burden on future-year taxpayers of paying for current services has changed; and
   - Whether the entity's ability to provide services has improved or deteriorated compared with the previous year.

3. Governments generally have broad powers, including the ability to establish and enforce legal requirements, and to change those requirements. Globally the public sector varies considerably in both its constitutional arrangements and its methods of operation. However, governance in the public sector generally involves the holding to account of the executive by a legislative body (or equivalent).

4. The following sections highlight characteristics of the public sector that the IPSASB has considered in the development of the Conceptual Framework.

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[1] The public sector includes national and sub-national (regional, state/provincial, and local), governments and related governmental entities. It also includes international public sector organizations.

The Volume and Financial Significance of Non-Exchange Transactions

5. In a non-exchange transaction, an entity receives value from another party without directly giving approximately equal value in exchange. Such transactions are common in the public sector. The level and quality of services received by an individual, or group of individuals, is not normally directly related to the level of taxes assessed. An individual or group may have to pay a charge or fee and/or may have had to make specified contributions to access certain services. However, such transactions are, generally, of a non-exchange nature, because the amount that an individual or group of individuals obtains in benefits will not be approximately equal to the amount of any fees paid or contributions made by the individual or group. The nature of non-exchange transactions may have an impact on how they are recognized, measured, and presented to best support assessments of the entity by service recipients and resource providers.

6. Taxation is a legally mandated, compulsory non-exchange transaction between individuals or entities and the government. Tax-raising powers can vary considerably, dependent upon the relationship between the powers of the national government and those of sub-national governments and other public sector entities. International public sector entities are largely funded by transfers from national, regional and state governments. Such funding may be governed by treaties and conventions or may be on a voluntary basis.

7. Governments and other public sector entities are accountable to resource providers, particularly to those that provide resources through taxes and other compulsory transactions. Chapter 2, *Objectives and Users of General Purpose Financial Reporting,* discusses the accountability objective of financial reporting.

The Importance of the Approved Budget

8. Most governments and other public sector entities prepare budgets. In many jurisdictions there is a constitutional requirement to prepare and make publicly available a budget approved by the legislature (or equivalent). Legislation often defines the contents of that documentation. The legislature (or equivalent) exercises oversight, and constituents and their elected representatives hold the entity's management financially accountable through the budget and other mechanisms. The approved budget is often the basis for setting taxation levels, and is part of the process for obtaining legislative approval for spending.

9. Because of the approved budget's significance, information that enables users to compare financial results with the budget facilitates an assessment of the extent to which a public sector entity has met its financial objectives. Such information promotes accountability and informs decision making in subsequent budgets. Reporting against budget is commonly the mechanism

for demonstrating compliance with legal requirements relating to the public finances. The needs of users for budget information is discussed in Chapter 2.

The Nature of Public Sector Programs and the Longevity of the Public Sector

10. Many public sector programs are long term and the ability to meet commitments depends upon future taxation and contributions. Many commitments arising from public sector programs and powers to levy future taxation do not meet the definitions of a liability and an asset in Chapter 5, *Elements in Financial Statements*. Therefore, such commitments and powers are not recognized in the financial statements.

11. Consequently, the statement of financial position and statement of financial performance cannot provide all the information that users need on long-term programs, particularly those delivering social benefits. The financial consequences of many decisions will have an impact many years or even decades into the future, so GPFRs containing prospective financial information on the long-term sustainability of an entity's finances and key programs are necessary for accountability and decision-making purposes as discussed in Chapter 2.

12. Although political control may change regularly, nation states generally have very long existences. While they may encounter severe financial difficulties and may default on sovereign debt obligations, nation states continue to exist. If sub-national entities get into financial difficulties, national governments might act as lenders of last resort or provide large scale guarantees. The main service delivery commitments of sub-national entities may continue to be funded by a higher level of government. In other cases public sector entities that are unable to meet their liabilities as they fall due may continue to exist by restructuring their operations.

13. The going concern principle underpins the preparation of the financial statements. Interpretation of the principle needs to reflect the issues discussed in paragraphs 11 and 12.

The Nature and Purpose of Assets and Liabilities in the Public Sector

14. In the public sector, the primary reason for holding property, plant, and equipment and other assets is for their service potential rather than their ability to generate cash flows[2]. Because of the types of services provided, a significant proportion of assets used by public sector entities is specialized—for example, roads and military assets. There may be a limited market for such assets and, even then, they may need considerable adaptation in order to be

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[2] Many public sector assets will generate cash flows, but this is often not the main reason for holding them.

used by other operators. These factors have implications for the measurement of such assets. Chapter 7, *Measurement of Assets and Liabilities in Financial Statements*, discusses measurement bases for assets.

15. Governments and other public sector entities may hold items that contribute to the historical and cultural character of a nation or region—for example, art treasures, historical buildings, and other artifacts. They may also be responsible for national parks and other areas of natural significance with native flora and fauna. Such items and areas are not generally held for sale, even if markets exist. Rather, governments and public sector entities have a responsibility to preserve and maintain them for current and future generations.

16. Governments often have powers over natural and other resources such as mineral reserves, water, fishing grounds, forests and the electromagnetic spectrum. These powers allow governments to grant licenses for the use of such resources or to obtain royalties and taxes from their use. The definition of an asset and recognition criteria are discussed in Chapters 5 and 6, *Recognition in Financial Statements*.

17. Governments and other public sector entities incur liabilities related to their service delivery objectives. Many liabilities arise from non-exchange transactions and include those related to programs that operate to deliver social benefits. Liabilities may also arise from governments' role as a lender of last resort and from any obligations to transfer resources to those affected by disasters. In addition many governments have obligations that arise from monetary activities such as currency in circulation. The definition of a liability and recognition criteria are discussed in Chapters 5 and 6.

The Regulatory Role of Public Sector Entities

18. Many governments and other public sector entities have powers to regulate entities operating in certain sectors of the economy, either directly or through specifically created agencies. The underlying public policy rationale for regulation is to safeguard the public interest in accordance with specified public policy objectives. Regulatory intervention can also occur where there are market imperfections or market failure for particular services, or to mitigate against factors such as pollution, the impact of which is not transmitted through pricing. Such regulatory activities are carried out in accordance with legal processes.

19. Governments may also regulate themselves and other public sector entities. Judgment may be necessary to determine whether such regulations create rights of, and obligations on, public sector entities that require recognition as assets and liabilities, or whether the public sector entity's ability to amend such regulations has an impact on how such rights and obligations are accounted for. Chapter 5 considers rights and obligations.

Relationship to Statistical Reporting

20. Many governments produce two types of ex-post financial information: (a) government finance statistics (GFS) on the general government sector (GGS) for the purpose of macroeconomic analysis and decision making, and (b) general purpose financial statements (financial statements) for accountability and decision making at an entity level, including financial statements for the whole of government reporting entity.

21. The overarching standards for macro-economic statistics are set out in the *System of National Accounts* (SNA). The SNA is a framework for a systematic and detailed description of the national economy and its components, including the GGS. These standards are then implemented at national or regional level, for example in the European Union through the European System of Accounts. GFS reporting guidelines include the International Monetary Fund's Government Finance Statistics Manual.

22. IPSAS financial statements and GFS reports have much in common. Both reporting frameworks are concerned with (a) financial, accrual-based information, (b) a government's assets, liabilities, revenue, and expenses and (c) comprehensive information on cash flows. There is considerable overlap between the two reporting frameworks that underpin this information.

23. However, IPSASs and GFS reporting guidelines have different objectives. The objectives of financial reporting by public sector entities are to provide information about the reporting entity that is useful to users of GPFRs for accountability purposes and decision-making purposes. GFS reports are used to (a) analyze fiscal policy options, make policy and evaluate the impact of fiscal policies, (b) determine the impact on the economy, and (c) compare fiscal outcomes nationally and internationally. The focus is on evaluating the impact of the GGS and broader public sector on the economy, within the complete macroeconomic statistics framework.

24. The different objectives and focus on different reporting entities lead to the different treatment of some transactions and events. The removal of differences between the two accounting frameworks that are not fundamental to their different objectives and reporting entities, and use of a single integrated financial information system to generate both IPSAS-compliant financial statements and GFS reports can provide benefits to users in terms of report quality, timeliness and understandability. These matters and their implications were considered in the development of Chapters 2, 4, *Reporting Entity*, and 7, which discuss the objectives of financial reporting, the reporting entity and measurement.

January 2013

CHAPTER 1: ROLE AND AUTHORITY OF THE CONCEPTUAL FRAMEWORK

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Role of the Conceptual Framework

1.1 The *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the Conceptual Framework) establishes the concepts that underpin general purpose financial reporting (financial reporting) by public sector entities that adopt the accrual basis of accounting. The International Public Sector Accounting Standards Board (IPSASB) will apply these concepts in developing International Public Sector Accounting Standards (IPSASs) and Recommended Practice Guidelines (RPGs) applicable to the preparation and presentation of general purpose financial reports (GPFRs) of public sector entities.

Authority of the Conceptual Framework

1.2 The Conceptual Framework does not establish authoritative requirements for financial reporting by public sector entities that adopt IPSASs, nor does it override the requirements of IPSASs or RPGs. Authoritative requirements relating to the recognition, measurement and presentation of transactions and other events and activities that are reported in GPFRs are specified in IPSASs.

1.3 The Conceptual Framework can provide guidance in dealing with financial reporting issues not dealt with by IPSASs or RPGs. In these circumstances, preparers and others can refer to and consider the applicability of the definitions, recognition criteria, measurement principles, and other concepts identified in the Conceptual Framework.

General Purpose Financial Reports

1.4 GPFRs are a central component of, and support and enhance, transparent financial reporting by governments and other public sector entities. GPFRs are financial reports intended to meet the information needs of users who are unable to require the preparation of financial reports tailored to meet their specific information needs.

1.5 Some users of financial information may have the authority to require the preparation of reports tailored to meet their specific information needs. While such parties may find the information provided by GPFRs useful for their purposes, GPFRs are not developed to specifically respond to their particular information needs.

1.6 GPFRs are likely to comprise multiple reports, each responding more directly to certain aspects of the objectives of financial reporting and matters included within the scope of financial reporting. GPFRs encompass financial statements including their notes (hereafter referred to as financial statements, unless specified otherwise), and the presentation of information that enhances, complements and supplements the financial statements.

1.7 The scope of financial reporting establishes the boundary around the transactions, other events and activities that may be reported in GPFRs. The scope of financial reporting is determined by the information needs of the primary users of GPFRs and the objectives of financial reporting. The factors that determine what may be encompassed within the scope of financial reporting are outlined in the next chapter.

Applicability of the Conceptual Framework

1.8 The Conceptual Framework applies to financial reporting by public sector entities that apply IPSASs. Therefore, it applies to GPFRs of national, regional, state/provincial and local governments. It also applies to a wide range of other public sector entities including:

- Government ministries, departments, programs, boards, commissions, agencies;
- Public sector social security funds, trusts, and statutory authorities; and
- International governmental organizations.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Role and Authority of the Conceptual Framework

BC1.1 The Conceptual Framework identifies the concepts that the IPSASB will apply in developing IPSASs and RPGs intended to assist preparers and others in dealing with financial reporting issues. IPSASs specify authoritative requirements. IPSASs and RPGs are developed after application of a due process which provides the opportunity for interested parties to provide input on the specific requirements proposed, including their compatibility with current practices in different jurisdictions.

BC1.2 The Conceptual Framework underpins the development of IPSASs. Therefore, it has relevance for all entities that apply IPSASs. GPFRs prepared at the whole-of-government level in accordance with IPSASs may also consolidate all governmental entities whether or not those entities have complied with IPSASs in their GPFRs.

Special Purpose Financial Reports

BC1.3 Standard setters often describe as "special purpose financial reports" those financial reports prepared to respond to the requirements of users that have the authority to require the preparation of financial reports that disclose the information they need for their particular purposes. The IPSASB is aware that the requirements of IPSASs have been (and may continue to be) applied effectively and usefully in the preparation of some special purpose financial reports.

General Purpose Financial Reports

BC1.4 The Conceptual Framework acknowledges that, to respond to users' information needs, GPFRs may include information that enhances, complements, and supplements the financial statements. Therefore, the Conceptual Framework reflects a scope for financial reporting that is more comprehensive than that encompassed by financial statements. The following Chapter of this Framework Chapter 2, *Objectives and Users of General Purpose Financial Reporting*, identifies the objectives of financial reporting and the primary users of GPFRs. It also outlines the consequences of the primary users' likely information needs for what may be encompassed within the scope of financial reporting.

CHAPTER 2: OBJECTIVES AND USERS OF GENERAL PURPOSE FINANCIAL REPORTING

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Objectives of Financial Reporting

2.1 The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability purposes and for decision-making purposes (hereafter referred to as "useful for accountability and decision-making purposes").

2.2 Financial reporting is not an end in itself. Its purpose is to provide information useful to users of GPFRs. The objectives of financial reporting are therefore determined by reference to the users of GPFRs, and their information needs.

Users of General Purpose Financial Reports

2.3 Governments and other public sector entities raise resources from taxpayers, donors, lenders and other resource providers for use in the provision of services to citizens and other service recipients. These entities are accountable for their management and use of resources to those that provide them with resources, and to those that depend on them to use those resources to deliver necessary services. Those that provide the resources and receive, or expect to receive, the services also require information as input for decision-making purposes.

2.4 Consequently, GPFRs of public sector entities are developed primarily to respond to the information needs of service recipients and resource providers who do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making purposes. The legislature (or similar body) and members of parliament (or a similar representative body) are also primary users of GPFRs, and make extensive and ongoing use of GPFRs when acting in their capacity as representatives of the interests of service recipients and resource providers. Therefore, for the purposes of the Conceptual Framework, the primary users of GPFRs are service recipients and their representatives and resource providers and their representatives (hereafter referred to as "service recipients and resource providers", unless identified otherwise).

2.5 Citizens receive services from, and provide resources to, the government and other public sector entities. Therefore, citizens are primary users of GPFRs. Some service recipients and some resource providers that rely on GPFRs for the information they need for accountability and decision-making purposes may not be citizens—for example, residents who pay taxes and/or receive benefits but are not citizens; multilateral or bilateral donor agencies and many lenders and corporations that provide resources to, and transact with, a government; and those that fund, and/or benefit from, the services provided by international governmental organizations. In most cases, governments that provide resources to international governmental organizations are dependent on GPFRs of those organizations for information for accountability and decision-making purposes.

2.6 GPFRs prepared to respond to the information needs of service recipients and resource providers for accountability and decision-making purposes may also provide information useful to other parties and for other purposes. For example, government statisticians, analysts, the media, financial advisors, public interest and lobby groups and others may find the information provided by GPFRs useful for their own purposes. Organizations that have the authority to require the preparation of financial reports tailored to meet their own specific information needs may also use the information provided by GPFRs for their own purposes—for example, regulatory and oversight bodies, audit institutions, subcommittees of the legislature or other governing body, central agencies and budget controllers, entity management, rating agencies and, in some cases, lending institutions and providers of development and other assistance. While these other parties may find the information provided by GPFRs useful, they are not the primary users of GPFRs. Therefore, GPFRs are not developed to specifically respond to their particular information needs.

Accountability and Decision Making

2.7 The primary function of governments and other public sector entities is to provide services that enhance or maintain the well-being of citizens and other eligible residents. Those services include, for example, welfare programs and policing, public education, national security and defense services. In most cases, these services are provided as a result of a non-exchange transaction[3] and in a non-competitive environment.

2.8 Governments and other public sector entities are accountable to those that provide them with resources, and to those that depend on them to use those resources to deliver services during the reporting period and over the longer term. The discharge of accountability obligations requires the provision of information about the entity's management of the resources entrusted to it for the delivery of services to constituents and others, and its compliance with legislation, regulation, or other authority that governs its service delivery and other operations. Given the way in which the services provided by public sector entities are funded (primarily by taxation revenues or other non-exchange transactions) and the dependency of service recipients on the provision of those services over the long term, the discharge of accountability obligations will also require the provision of information about such matters as the entity's service delivery achievements during the reporting period, and its capacity to continue to provide services in future periods.

2.9 Service recipients and resource providers will also require information as input for making decisions. For example:

[3] Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equally value to another entity in exchange. Non-exchange transactions are transactions in which an entity receives value from another entity without directly giving approximately equal value in exchange.

- Lenders, creditors, donors and others that provide resources on a voluntary basis, including in an exchange transaction, make decisions about whether to provide resources to support the current and future activities of the government or other public sector entity. In some circumstances, members of the legislature or similar representative body who depend on GPFRs for the information they need, can make or influence decisions about the service delivery objectives of government departments, agencies or programs and the resources allocated to support their achievement; and

- Taxpayers do not usually provide funds to the government or other public sector entity on a voluntary basis or as a result of an exchange transaction. In addition, in many cases, they do not have the discretion to choose whether or not to accept the services provided by a public sector entity or to choose an alternative service provider. Consequently, they have little direct or immediate capacity to make decisions about whether to provide resources to the government, the resources to be allocated for the provision of services by a particular public sector entity or whether to purchase or consume the services provided. However, service recipients and resource providers can make decisions about their voting preferences, and representations they make to elected officials or other representative bodies—these decisions may have resource allocation consequences for certain public sector entities.

2.10 Information provided in GPFRs for accountability purposes will contribute to, and inform, decision making. For example, information about the costs, efficiency and effectiveness of past service delivery activities, the amount and sources of cost recovery, and the resources available to support future activities will be necessary for the discharge of accountability. This information will also be useful for decision making by users of GPFRs, including decisions that donors and other financial supporters make about providing resources to the entity.

Information Needs of Service Recipients and Resource Providers

2.11 For accountability and decision-making purposes, service recipients and resource providers will need information that supports the assessments of such matters as:

- The performance of the entity during the reporting period in, for example:
    - Meeting its service delivery and other operating and financial objectives;
    - Managing the resources it is responsible for;

    - Complying with relevant budgetary, legislative, and other authority regulating the raising and use of resources;

- The liquidity (for example, ability to meet current obligations) and solvency (for example, ability to meet obligations over the long term) of the entity;
- The sustainability of the entity's service delivery and other operations over the long term, and changes therein as a result of the activities of the entity during the reporting period including, for example:
    - The capacity of the entity to continue to fund its activities and to meet its operational objectives in the future (its financial capacity), including the likely sources of funding and the extent to which the entity is dependent on, and therefore vulnerable to, funding or demand pressures outside its control; and
    - The physical and other resources currently available to support the provision of services in future periods (its operational capacity); and
- The capacity of the entity to adapt to changing circumstances, whether changes in demographics or changes in domestic or global economic conditions which are likely to impact the nature or composition of the activities it undertakes and the services it provides.

2.12 The information service recipients and resource providers need for these purposes is likely to overlap in many respects. For example, service recipients will require information as input to assessments of such matters as whether:

- The entity is using resources economically, efficiently, effectively and as intended, and whether such use is in their interest;
- The range, volume and cost of services provided during the reporting period are appropriate, and the amounts and sources of their cost recoveries; and
- Current levels of taxes or other resources raised are sufficient to maintain the volume and quality of services currently provided.

Service recipients will also require information about the consequences of decisions made, and activities undertaken, by the entity during the reporting period on the resources available to support the provision of services in future periods, the entity's anticipated future service delivery activities and objectives, and the amounts and sources of cost recoveries necessary to support those activities.

2.13 Resource providers will require information as input to assessments of such matters as whether the entity:

- Is achieving the objectives established as the justification for the resources raised during the reporting period;
- Funded current operations from funds raised in the current period from taxpayers or from borrowings or other sources; and
- Is likely to need additional (or less) resources in the future, and the likely sources of those resources.

Lenders and creditors will require information as input to assessments of the liquidity of the entity and, therefore, whether the amount and timing of repayment will be as agreed. Donors will require information to support assessments of whether the entity is using resources economically, efficiently, effectively and as intended. They will also require information about the entity's anticipated future service delivery activities and resource needs.

Information Provided by General Purpose Financial Reports

Financial Position, Financial Performance and Cash Flows

2.14 Information about the financial position of a government or other public sector entity will enable users to identify the resources of the entity and claims to those resources at the reporting date. This will provide information useful as input to assessments of such matters as:

- The extent to which management has discharged its responsibilities for safekeeping and managing the resources of the entity;
- The extent to which resources are available to support future service delivery activities, and changes during the reporting period in the amount and composition of those resources and claims to those resources; and
- The amounts and timing of future cash flows necessary to service and repay existing claims to the entity's resources.

2.15 Information about the financial performance of a government or other public sector entity will inform assessments of matters such as whether the entity has acquired resources economically, and used them efficiently and effectively to achieve its service delivery objectives. Information about the costs of service delivery and the amounts and sources of cost recovery during the reporting period will assist users to determine whether operating costs were recovered from, for example, taxes, user charges, contributions and transfers, or were financed by increasing the level of indebtedness of the entity.

2.16 Information about the cash flows of a government or other public sector entity contributes to assessments of financial performance and the entity's liquidity and solvency. It indicates how the entity raised and used cash during the period, including its borrowing and repayment of borrowing and its acquisition and sale of, for example, property, plant, and equipment. It also identifies the cash received from, for example, taxes and investments and the cash transfers made to, and received from, other governments, government agencies or international organizations. Information about cash flows can also support assessments of the entity's compliance with spending mandates expressed in cash flow terms, and inform assessments of the likely amounts and sources of cash inflows needed in future periods to support service delivery objectives.

2.17 Information about financial position, financial performance and cash flows are typically presented in financial statements. To assist users to better understand, interpret and place in context the information presented in the financial statements, GPFRs may also provide financial and non-financial information that enhances, complements and supplements the financial statements, including information about such matters as the government's or other public sector entity's:

- Compliance with approved budgets and other authority governing its operations;
- Service delivery activities and achievements during the reporting period; and
- Expectations regarding service delivery and other activities in future periods, and the long term consequences of decisions made and activities undertaken during the reporting period, including those that may impact expectations about the future.

This information may be presented in the notes to the financial statements or in separate reports included in GPFRs.

Budget Information and Compliance with Legislation or Other Authority Governing the Raising and Use of Resources

2.18 Typically, a government or other public sector entity prepares, approves and makes publicly available an annual budget. The approved budget provides interested parties with financial information about the entity's operational plans for the forthcoming period, its capital needs and, often, its service delivery objectives and expectations. It is used to justify the raising of resources from taxpayers and other resource providers, and establishes the authority for expenditure of resources.

2.19 Some resources to support the activities of public sector entities may be received from donors, lenders or as a result of exchange transactions. However, resources to support the activities of public sector entities are predominantly provided in non-exchange transactions by taxpayers and others, consistent with the expectations reflected in an approved budget.

2.20 GPFRs provide information about the financial results (whether described as "surplus or deficit," "profit or loss," or by other terms), performance and cash flows of the entity during the reporting period, its assets and liabilities at the reporting date and the change therein during the reporting period, and its service delivery achievements.

2.21 The inclusion within GPFRs of information that assists users in assessing the extent to which revenues, expenses, cash flows and financial results of the entity comply with the estimates reflected in approved budgets, and the entity's adherence to relevant legislation or other authority governing the raising and use of resources, is important in determining how well a public sector entity has met its financial objectives. Such information is necessary for the discharge of a government's or other public sector entity's accountability to its constituents, enhances the assessment of the financial performance of the entity and will inform decision making.

Service Delivery Achievements

2.22 The primary objective of governments and most public sector entities is to provide needed services to constituents. Consequently, the financial performance of governments and most public sector entities will not be fully or adequately reflected in any measure of financial results. Therefore, their financial results will need to be assessed in the context of the achievement of service delivery objectives.

2.23 In some cases, quantitative measures of the outputs and outcomes of the entity's service delivery activities during the reporting period will provide relevant information about the achievement of service delivery objectives—for example, information about the cost, volume, and frequency of service delivery, and the relationship of services provided to the resource base of the entity. In other cases, the achievement of service delivery objectives may need to be communicated by an explanation of the quality of particular services provided or the outcome of certain programs.

2.24 Reporting non-financial as well as financial information about service delivery activities, achievements and/or outcomes during the reporting period will provide input to assessments of the economy, efficiency, and effectiveness of the entity's operations. Reporting such information is necessary for a government or other public sector entity to discharge its obligation to be accountable—that is, to account for, and justify the use of, the resources raised from, or on behalf of, constituents. Decisions that donors make about the allocation of resources to particular entities and programs are also made, at least in part, in response to information about service delivery achievements during the reporting period, and future service delivery objectives.

Prospective Financial and Non-financial Information

2.25 Given the longevity of governments and many government programs, the financial consequences of many decisions made in the reporting period may only become clear many years into the future. Financial statements which present information about financial position at a point in time and financial performance and cash flows over the reporting period will then need to be assessed in the context of the long term.

2.26 Decisions made by a government or other public sector entity in a particular period about programs for delivering and funding services in the future can have significant consequences for:

- Constituents who will be dependent on those services in the future; and
- Current and future generations of taxpayers and other involuntary resource providers who will provide the taxes and levies to fund the planned service delivery activities and related financial commitments.

2.27 Information about the entity's anticipated future service delivery activities and objectives, their likely impact on the future resource needs of the entity and the likely sources of funding for such resources, will be necessary as input to any assessment of the ability of the government or other public sector entity to meet its service delivery and financial commitments in the future. The disclosure of such information in GPFRs will support assessments of the sustainability of service delivery by a government or other public sector entity, enhance the accountability of the entity and provide additional information useful for decision-making purposes.

Explanatory Information

2.28 Information about the major factors underlying the financial and service delivery performance of the entity during the reporting period and the assumptions that underpin expectations about, and factors that are likely to influence, the entity's future performance may be presented in GPFRs in notes to the financial statements or in separate reports. Such information will assist users to better understand and place in context the financial and non-financial information included in GPFRs, and enhance the role of GPFRs in providing information useful for accountability and decision-making purposes.

Financial Statements and Information that Enhances, Complements and Supplements the Financial Statements

2.29 The scope of financial reporting establishes the boundary around the transactions, other events and activities that may be reported in GPFRs. To respond to the information needs of users, the Conceptual Framework reflects a scope for financial reporting that is more comprehensive than that encompassed by financial statements. It provides for the presentation within GPFRs of additional information that enhances, complements, and supplements those statements.

2.30 While the Conceptual Framework reflects a scope of financial reporting that is more comprehensive than that encompassed by financial statements, information presented in financial statements remains at the core of financial reporting. How the elements of financial statements are defined, recognized and measured, and forms of presentation and communication that might be adopted for information included within GPFRs, is considered in other chapters of the Conceptual Framework and in the development of individual IPSASs or RPGs, as appropriate.

Other Sources of Information

2.31 GPFRs play a significant role in communicating information necessary to support the discharge of a government's or other public sector entity's obligation to be accountable, as well as providing information useful as input for decision-making purposes. However, it is unlikely that GPFRs will provide all the information users need for accountability and decision-making purposes. For example, while comparison of actual with budget information for the reporting period may be included in GPFRs, the budgets and financial forecasts issued by governments provide more detailed financial and non-financial information about the financial characteristics of the plans of governments and other public sector entities over the short and medium terms. Governments and independent agencies also issue reports on the need for, and sustainability of, existing service delivery initiatives and anticipated economic conditions and changes in the jurisdiction's demographics over the medium and longer term that will influence budgets and service delivery needs in the future. Consequently, service recipients and resource providers may also need to consider information from other sources, including reports on current and anticipated economic conditions, government budgets and forecasts, and information about government policy initiatives not reported in GPFRs.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Primary User Groups

BC2.1 In developing the Conceptual Framework, the IPSASB sought views on whether the Conceptual Framework should identify the primary users of GPFRs. Many respondents to the initial Consultation Paper[4] expressed the view that the Framework should identify the primary users of GPFRs, and the IPSASB should focus on the information needs of those primary users in developing IPSASs. The IPSASB was persuaded by these views.

Identifying the Primary User Groups

BC2.2 Conceptual Framework Exposure Draft 1, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity* (the Exposure Draft) identified service recipients and their representatives, and resource providers and their representatives as the primary users of GPFRs. It explained that, while the IPSASB will develop IPSASs and RPGs on the contents of GPFRs to respond to the information needs of these primary users, GPFRs may still be used by others with an interest in financial reporting, and may provide information of use to those other users.

BC2.3 Many respondents to the Exposure Draft expressed support for the identification of service recipients and their representatives and resource providers and their representatives as the primary users of GPFRs. However, others were of the view that the public, citizens or legislature should be identified as the primary or most important users of GPFRs of public sector entities. They explained that this is because governments are primarily accountable to the citizens or their representatives and, in many jurisdictions, the legislature and individual members of parliament (or similar representative body) acting on behalf of citizens are the main users of GPFRs. Some respondents also expressed the view that only resource providers and their representatives should be identified as the primary users of GPFRs of public sector entities. They explained that it is unlikely that GPFRs would be able to respond to the information needs of all users, and resource providers are likely to have the greatest interest in GPFRs. Therefore, identifying resource providers as the primary user group will allow the IPSASB to focus more sharply on the information needs of a single

[4] Consultation Paper, *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities: The Objectives of Financial Reporting; The Scope of Financial Reporting; The Qualitative Characteristics of Information Included in General Purpose Financial Reports; The Reporting Entity*.

user group. They also noted that GPFRs prepared to respond to the information needs of resource providers are likely to also provide information useful to other potential users.

BC2.4 The IPSASB acknowledges that there is merit in many of the proposals made by respondents regarding the identity of the primary users of GPFRs of public sector entities, particularly as they apply to governments in many jurisdictions. However, given the objectives of financial reporting by public sector entities, the IPSASB remains of the view that the primary users of GPFRs of public sector entities should be identified as service recipients and their representatives and resource providers and their representatives. This is because:

- Governments and other public sector entities are accountable to those that depend on them to use resources to deliver necessary services, as well as to those that provide them with the resources that enable the delivery of those services; and
- GPFRs have a significant role in the discharge of that accountability and the provision of information useful to those users for decision-making purposes.

As such, GPFRs should be developed to respond to the information needs of service recipients and their representatives and resource providers and their representatives as the primary users. In addition, the Conceptual Framework will apply to governments and a potentially wide range of other public sector entities in many different jurisdictions, and to international governmental organizations. Consequently, it is not clear that identification of other user groups as the primary users of GPFRs will be relevant, and operate effectively, for all public sector entities across all jurisdictions.

BC2.5 The IPSASB accepts that some information in GPFRs may be of more interest and greater use to some users than others. The IPSASB also accepts that, in developing IPSASs and RPGs, it will need to consider and, in some cases, balance the needs of different groups of primary users. However, the IPSASB does not believe that such matters invalidate the identification of both service recipients and their representatives and resource providers and their representatives as the primary users of GPFRs.

BC2.6 The IPSASB's views on the relationship between the primary user groups identified by respondents, and service recipients and resource providers are further elaborated below.

Citizens

BC2.7 The IPSASB acknowledges the importance of citizens, the public and their representatives as users of GPFRs, but is of the view that classifying citizens as service recipients and resource providers provides a basis for assessing their potential information needs. This is because citizens encompass many individuals with a potentially wide range of diverse information needs—focusing on the information needs of citizens as service recipients and resource providers enables the IPSASB to draw together those diverse interests and explore what information needs GPFRs should attempt to respond to. The IPSASB is also of the view that, in developing IPSASs, it is appropriate that it has the capacity to consider the information needs of a range of service recipients and resource providers who may not be citizens (including donors and lenders) and do not possess the authority to require a public sector entity to disclose the information they need for accountability and decision-making purposes.

Resource Providers

BC2.8 The IPSASB agrees that GPFRs directed at the provision of information to satisfy the information needs of resource providers will also provide information useful to other potential users of GPFRs. However, the IPSASB is of the view that the Conceptual Framework should make clear its expectation that governments and other public sector entities should be accountable to both those that provide them with resources and those that depend on them to use those resources to deliver necessary and/or promised services. In addition, it has been noted that in some jurisdictions resource providers are primarily donors or lenders that may have the authority to require the preparation of special purpose financial reports to provide the information they need.

BC2.9 As noted at paragraph BC2.4, the IPSASB has formed a view that both service recipients and resource providers and their representatives are primary users of GPFRs. The IPSASB is of the view that the Conceptual Framework should not exclude citizens who may be interested in GPFRs in their capacity as service recipients from the potential users of GPFRs, or identify their information needs as less important than those of resource providers. The IPSASB is also of the view that it is not appropriate that donors, lenders, and others that provide resources on a voluntary or involuntary basis to governments and other public sector entities be excluded as potential users of GPFRs, or that their information needs be identified as less important than those of service recipients.

The Legislature

BC2.10 The IPSASB is of the view that the legislature or similar governing body is a primary user of GPFRs in its capacity as a representative of service recipients and resource providers. The legislature, parliaments, councils and similar bodies will also require information for their own specific accountability and decision-making purposes, and usually have the authority to require the preparation of detailed special purpose financial and other reports to provide that information. However, they may also use the information provided by GPFRs as well as information provided by special purpose financial reports for input to assessments of whether resources were used efficiently and as intended and in making decisions about allocating resources to particular government entities, programs or activities.

BC2.11 Individual members of the legislature or other governing body, whether members of the government or opposition, can usually require the disclosure of the information they need for the discharge of their official duties as directed by the legislature or governing body. However, they may not have the authority to require the preparation of financial reports that provide the information they require for other purposes, or in other circumstances. Consequently, they are users of GPFRs, whether in their capacity as representatives of service recipients and resource providers in their electorate or constituency, or in their personal capacity as citizens and members of the community.

Other User Groups

BC2.12 In developing the Conceptual Framework, the IPSASB considered a wide range of other potential users of GPFRs, including whether special interest groups and their representatives, or those transacting with public sector entities on a commercial or non-commercial basis or on a voluntary or involuntary basis (such as public sector and private sector resource providers) should be identified as separate user groups. The IPSASB is of the view that identifying service recipients and their representatives and resource providers and their representatives as the primary users of GPFRs will respond appropriately to the information needs of subgroups of service recipients and resource providers.

BC2.13 The information provided by GPFRs may be useful for compiling national accounts, as input to statistical financial reporting models, for assessments of the impact of government policies on economic activity and for other economic analytical purposes. However, GPFRs are not developed specifically to respond to the needs of those who require information for these purposes. Similarly, while those that act as advisors to service recipients or to resource providers (such as citizen advocacy groups, bond rating agencies, credit analysts and public interest groups) are likely to find the information reported in GPFRs useful for their purposes, GPFRs are not prepared specifically to respond to their particular information needs.

The Objectives of Financial Reporting

BC2.14 Many respondents to the Exposure Draft agreed that the provision of information useful for both accountability and decision-making purposes should be identified as the objectives of financial reporting by public sector entities. Some respondents advocated that only accountability be identified as the single or dominant objective of financial reporting by public sector entities; other respondents advocated that decision making should be identified as the single objective. However, the IPSASB remains of the view that users of GPFRs of public sector entities will require information for both accountability and decision-making purposes.

BC2.15 Some respondents to the Exposure Draft advocated that the link between accountability and decision making be more clearly articulated and the public sector characteristics that underpinned the IPSASB's views on the objectives of financial reporting by public sector entities be identified. The IPSASB has responded positively to these proposals. The Framework has been restructured and clarifications added.

BC2.16 The explanation of accountability and its relationship to decision-making and GPFRs has also been strengthened. In this context, the IPSASB acknowledges that the notion of accountability reflected in this Framework is broad. It encompasses the provision of information about the entity's management of the resources entrusted to it, and information useful to users in assessing the sustainability of the activities of the entity and the continuity of the provision of services over the long term. The IPSASB is of the view that this broad notion of accountability is appropriate because citizens and other constituents provide resources to governments and other public sector entities on an involuntary basis and, for the most part, depend on governments and other public sector entities to provide needed services over the long term. However, the IPSASB also recognizes that it is unlikely that GPFRs will provide all the information that service recipients and resource providers need for accountability and decision-making purposes.

The Scope of Financial Reporting—Financial Statements and Information that Enhances, Complements and Supplements the Financial Statements

BC2.17 Many respondents to the Exposure Draft expressed support for the scope of financial reporting and its explanation as proposed by the IPSASB, with some identifying matters for clarification and others noting that projects dealing with the broader scope issues would need to provide guidance on application of the qualitative characteristics such as verifiability and comparability. Other respondents did not support the scope of financial reporting being broader than financial statements, expressing concern that:

- The proposed broad scope dealt with matters which were outside the Terms of Reference of the IPSASB that were in effect at that time; and
- Guidance on matters outside the financial statements, such as non-financial and prospective information, is appropriately a matter for individual governments, or governing bodies or other authority.
- Some respondents to the Exposure Draft also expressed concern that the scope was too sharply focused on the financial statements, and

that additional guidance on non-financial information and sustainability reporting be included in the Conceptual Framework.

BC2.18 The IPSASB remains of the view that it is necessary that the Conceptual Framework reflect a scope for financial reporting that is more comprehensive than that encompassed by financial statements. This is because:

- The primary objective of governments and other public sector entities is to deliver services to constituents rather than to generate profits;
- Citizens and other eligible residents are dependent on governments and other public sector entities to provide a wide range of services on an on-going basis over the long term. The activities of, and decisions made by, governments and other public sector entities in a particular reporting period can have significant consequences for future generations of service recipients and future generations of taxpayers and other involuntary resource providers; and
- Most governments and other public sector entities operate within spending mandates and financial constraints established through the budgetary process. Monitoring implementation of the approved budget is the primary method by which the legislature exercises oversight, and citizens and their elected representatives hold the government's management financially accountable.

BC2.19 Consequently, the performance of public sector entities in achieving their financial and service delivery objectives can be only partially evaluated by examination of their financial position at the reporting date, and financial performance and cash flows during the reporting period. The IPSASB is of the view that, to respond to users' need for information for accountability and decision-making purposes, the Conceptual Framework should enable GPFRs to encompass the provision of information that allows users to better assess and place in context the financial statements. Such information may be communicated by separate reports that present financial and non-financial information about the achievement of the entity's service delivery objectives during the reporting period; its compliance with approved budgets and legislation or other authority governing the raising and use of resources; and prospective financial and non-financial information about its future service delivery activities, objectives, and resource needs. In some cases, information about these matters may also be presented in notes to the financial statements.

BC2.20 In making decisions about financial reporting requirements or guidance that extend the information presented in GPFRs beyond financial statements, the IPSASB will consider the benefits of the information to users and the costs of compiling and reporting such information.

Limiting the Scope of Financial Reporting

BC2.21 Some respondents who agreed that the scope of financial reporting should extend beyond the financial statements expressed concern that the scope as proposed in the Exposure Draft was too open ended and/or not adequately explained or justified—in some cases proposing that the scope be limited to enhancement of matters recognized in the financial statements.

BC2.22 The IPSASB has responded to these concerns by clarifying the linkages between the scope of financial reporting and users' information needs, and including additional explanation of the relationship between users' information needs and the information that GPFRs may provide in response. In addition, the IPSASB has clarified that the scope of general purpose financial reporting is limited to the financial statements and information that enhances, complements and supplements the financial statements. Consequently, what is included in the more comprehensive scope of financial reporting will be derived from financial statements, and limited to matters that assist users to better understand and put in context the information included in those statements.

Resource Considerations, Authoritative Requirements and Audit Status

BC2.23 Many respondents, whether supportive or opposed to the proposals in the Exposure Draft, expressed concern that dealing with "broad scope" issues would absorb too much of the IPSASB's resources and limit its ability to deal with financial statement issues. Some respondents to the Exposure Draft also:

- Advocated that the Conceptual Framework clarify that authoritative requirements would only be developed for financial statement matters, broader scope issues being the subject of guidelines; and
- Expressed concern about the audit implications of including non-financial information and prospective information in GPFRs.

BC2.24 While the IPSASB can develop IPSASs which include authoritative requirements, it is not inevitable that it will do so. For example, the IPSASB's publications also include RPGs and other documents intended to assist the financial reporting community to respond to particular financial reporting issues. All IPSASB documents which include authoritative requirements or guidance on the presentation of information in GPFRs, whether as part of the financial statements or enhancements to those statements, will be subject to full due process. Therefore, in developing authoritative or other guidance on the presentation of information that broadens the scope of financial reporting, the IPSASB will need to respond to constituent concerns about the proposed technical content and authority of the guidance.

BC2.25 The IPSASB acknowledges the concern of respondents regarding the deployment of the IPSASB's resources to broad scope issues. However, information presented in financial statements remains at the core of financial reporting and, therefore, will remain the primary focus of the IPSASs and RPGs developed by the IPSASB. Consequently, the standards development work program of the IPSASB will continue to respond to users' need for better financial reporting of transactions and other events that are reported in the financial statements.

BC2.26 The IPSASB is of the view that it is not the role of the Conceptual Framework, or the IPSASs and RPGs that may be developed consistent with the concepts reflected in the Framework, to attempt to establish the level of audit assurance that should be provided to particular aspects of GPFRs. The qualitative characteristics provide some assurance to users about the quality of information included in GPFRs. However, responsibilities for the audit of financial statements and other components of GPFRs will be established by such matters as the regulatory framework in place in particular jurisdictions and the audit mandate agreed with and/or applying to the entity.

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CHAPTER 3: QUALITATIVE CHARACTERISTICS

CONTENTS

Introduction

3.1 GPFRs present financial and non-financial information about economic and other phenomena. The qualitative characteristics of information included in GPFRs are the attributes that make that information useful to users and support the achievement of the objectives of financial reporting. The objectives of financial reporting are to provide information useful for accountability and decision-making purposes.

3.2 The qualitative characteristics of information included in GPFRs of public sector entities are relevance, faithful representation, understandability, timeliness, comparability, and verifiability.

3.3 Pervasive constraints on information included in GPFRs are materiality, cost-benefit, and achieving an appropriate balance between the qualitative characteristics.

3.4 Each of the qualitative characteristics is integral to, and works with, the other characteristics to provide in GPFRs information useful for achieving the objectives of financial reporting. However, in practice, all qualitative characteristics may not be fully achieved, and a balance or trade-off between certain of them may be necessary.

3.5 The qualitative characteristics apply to all financial and non-financial information reported in GPFRs, including historic and prospective information, and explanatory information. However, the extent to which the qualitative characteristics can be achieved may differ depending on the degree of uncertainty and subjective assessment or opinion involved in compiling the financial and non-financial information. The need for additional guidance on interpreting and applying the qualitative characteristics to information that extends the scope of financial reporting beyond financial statements will be considered in the development of any IPSASs and RPGs that deal with such matters.

Relevance

3.6 Financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. Financial and non-financial information is capable of making a difference when it has confirmatory value, predictive value, or both. It may be capable of making a difference, and thus be relevant, even if some users choose not to take advantage of it or are already aware of it.

3.7 Financial and non-financial information has confirmatory value if it confirms or changes past (or present) expectations. For example, information will be relevant for accountability and decision-making purposes if it confirms expectations about such matters as the extent to which managers have discharged their responsibilities for the efficient and effective use of resources, the achievement of specified service delivery objectives, and compliance with relevant budgetary, legislative and other requirements.

3.8 GPFRs may present information about an entity's anticipated future service delivery activities, objectives and costs, and the amount and sources of the resources that are intended to be allocated to providing services in the future. Such future oriented information will have predictive value and be relevant for accountability and decision-making purposes. Information about economic and other phenomena that exist or have already occurred can also have predictive value in helping form expectations about the future. For example, information that confirms or disproves past expectations can reinforce or change expectations about financial results and service delivery outcomes that may occur in the future.

3.9 The confirmatory and predictive roles of information are interrelated—for example, information about the current level and structure of an entity's resources and claims to those resources helps users to confirm the outcome of resource management strategies during the period, and to predict an entity's ability to respond to changing circumstances and anticipated future service delivery needs. The same information helps to confirm or correct users' past expectations and predictions about the entity's ability to respond to such changes. It also helps to confirm or correct prospective financial information included in previous GPFRs.

Faithful Representation

3.10 To be useful in financial reporting, information must be a faithful representation of the economic and other phenomena that it purports to represent. Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error. Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form.

3.11 In practice, it may not be possible to know or confirm whether information presented in GPFRs is complete, neutral, and free from material error. However, information should be as complete, neutral, and free from error as is possible.

3.12 An omission of some information can cause the representation of an economic or other phenomenon to be false or misleading, and thus not useful to users of GPFRs. For example, a complete depiction of the item "plant and equipment" in GPFRs will include a numeric representation of the aggregate amount of plant and equipment together with other quantitative, descriptive and explanatory information necessary to faithfully represent that class of assets. In some cases, this may include the disclosure of information about such matters as the major classes of plant and equipment, factors that have affected their use in the past or might impact on their use in the future, and the basis and process for determining their numeric representation. Similarly, prospective financial and non-financial information and information about the achievement of service delivery objectives and outcomes included in GPFRs will need to be presented with the key assumptions that underlie that information and any explanations that are necessary to ensure that its depiction is complete and useful to users.

3.13 Neutrality in financial reporting is the absence of bias. It means that the selection and presentation of financial and non-financial information is not made with the intention of attaining a particular predetermined result—for example, to influence in a particular way users' assessment of the discharge of accountability by the entity or a decision or judgment that is to be made, or to induce particular behavior.

3.14 Neutral information faithfully represents the economic and other phenomena that it purports to represent. However, to require information included in GPFRs to be neutral does not mean that it is not without purpose or that it will not influence behavior. Relevance is a qualitative characteristic and, by definition, relevant information is capable of influencing users' assessments and decisions.

3.15 The economic and other phenomena represented in GPFRs generally occur under conditions of uncertainty. Information included in GPFRs will therefore often include estimates that incorporate management's judgment. To faithfully represent an economic or other phenomenon, an estimate must be based on appropriate inputs, and each input must reflect the best available information. Caution will need to be exercised when dealing with uncertainty. It may sometimes be necessary to explicitly disclose the degree of uncertainty in financial and non-financial information to faithfully represent economic and other phenomena.

3.16 Free from material error does not mean complete accuracy in all respects. Free from material error means there are no errors or omissions that are individually or collectively material in the description of the phenomenon, and the process used to produce the reported information has been applied as described. In some cases, it may be possible to determine the accuracy of some information included in GPFRs—for example, the amount of a cash transfer to another level of government, the volume of services delivered or the price paid for the acquisition of plant and equipment. However, in other cases it may not—for example, the accuracy of an estimate of the value or cost of an item or the effectiveness of a service delivery program may not be able to be determined. In these cases, the estimate will be free from material error if the amount is clearly described as an estimate, the nature and limitations of the estimation process are explained, and no material errors have been identified in selecting and applying an appropriate process for developing the estimate.

Understandability

3.17 Understandability is the quality of information that enables users to comprehend its meaning. GPFRs of public sector entities should present information in a manner that responds to the needs and knowledge base of users, and to the nature of the information presented. For example, explanations of financial and non-financial information and commentary on service delivery and other achievements during the reporting period and expectations for future periods should be written in plain language, and presented in a manner that is readily understandable by users. Understandability is enhanced when information is classified, characterized, and presented clearly and concisely. Comparability also can enhance understandability.

3.18 Users of GPFRs are assumed to have a reasonable knowledge of the entity's activities and the environment in which it operates, to be able and prepared to read GPFRs, and to review and analyze the information presented with reasonable diligence. Some economic and other phenomena are particularly complex and difficult to represent in GPFRs, and some users may need to seek the aid of an advisor to assist in their understanding of them. All efforts should be undertaken to represent economic and other phenomena included in GPFRs in a manner that is understandable to a wide range of users. However, information should not be excluded from GPFRs solely because it may be too complex or difficult for some users to understand without assistance.

Timeliness

3.19 Timeliness means having information available for users before it loses its capacity to be useful for accountability and decision-making purposes. Having relevant information available sooner can enhance its usefulness as input to assessments of accountability and its capacity to inform and influence decisions that need to be made. A lack of timeliness can render information less useful.

3.20 Some items of information may continue to be useful long after the reporting period or reporting date. For example, for accountability and decision-making purposes, users of GPFRs may need to assess trends in the financial and service delivery performance of the entity and its compliance with budgets over a number of reporting periods. In addition, the outcome and effects of some service delivery programs may not be determinable until future periods—for example, this may occur in respect of programs intended to enhance the economic well-being of constituents, reduce the incidence of a particular disease, or increase literacy levels of certain age groups.

Comparability

3.21 Comparability is the quality of information that enables users to identify similarities in, and differences between, two sets of phenomena. Comparability is not a quality of an individual item of information, but rather a quality of the relationship between two or more items of information.

3.22 Comparability differs from consistency. Consistency refers to the use of the same accounting principles or policies and basis of preparation, either from period to period within an entity or in a single period across more than one entity. Comparability is the goal, and consistency helps in achieving that goal. In some cases, the accounting principles or policies adopted by an entity may be revised to better represent a particular transaction or event in GPFRs. In these cases, the inclusion of additional disclosures or explanation may be necessary to satisfy the characteristics of comparability.

3.23 Comparability also differs from uniformity. For information to be comparable, like things must look alike and different things must look different. An over-emphasis on uniformity may reduce comparability by making unlike things look alike. Comparability of information in GPFRs is not enhanced by making unlike things look alike, any more than it is by making like things look different.

3.24 Information about the entity's financial position, financial performance, cash flows, compliance with approved budgets and relevant legislation or other authority governing the raising and use of resources, service delivery achievements, and its future plans is necessary for accountability purposes and useful as input for decision-making purposes. The usefulness of such information is enhanced if it can be compared with, for example:

- Prospective financial and non-financial information previously presented for that reporting period or reporting date;
- Similar information about the same entity for some other period or some other point in time; and
- Similar information about other entities (for example, public sector entities providing similar services in different jurisdictions) for the same reporting period.

3.25 Consistent application of accounting principles, policies and basis of preparation to prospective financial and non-financial information and actual outcomes will enhance the usefulness of any comparison of projected and actual results. Comparability with other entities may be less significant for explanations of management's perception or opinion of the factors underlying the entity's current performance.

Verifiability

3.26 Verifiability is the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent. Supportability is sometimes used to describe this quality when applied in respect of explanatory information and prospective financial and non-financial quantitative information disclosed in GPFRs—that is, the quality of information that helps assure users that explanatory or prospective financial and non-financial quantitative information faithfully represents the economic and other phenomena that it purports to represent. Whether referred to as verifiability or supportability, the characteristic implies that different knowledgeable and independent observers could reach general consensus, although not necessarily complete agreement, that either:

- The information represents the economic and other phenomena that it purports to represent without material error or bias; or
- An appropriate recognition, measurement, or representation method has been applied without material error or bias.

3.27 To be verifiable, information need not be a single point estimate. A range of possible amounts and the related probabilities also can be verified.

3.28 Verification may be direct or indirect. With direct verification, an amount or other representation is itself verified, such as by (a) counting cash, (b) observing marketable securities and their quoted prices, or (c) confirming that the factors identified as influencing past service delivery performance were present and operated with the effect identified. With indirect verification, the amount or other representation is verified by checking the inputs and recalculating the outputs using the same accounting convention or methodology. An example is verifying the carrying amount of inventory by checking the inputs (quantities and costs) and recalculating the ending inventory using the same cost flow assumption (for example, average cost or first-in-first-out).

3.29 The quality of verifiability (or supportability if such term is used to describe this characteristic) is not an absolute—some information may be more or less capable of verification than other information. However, the more verifiable is the information included in GPFRs, the more it will assure users that the information faithfully represents the economic and other phenomena that it purports to represent.

3.30 GPFRs of public sector entities may include financial and other quantitative information and explanations about (a) key influences on the entity's performance during the period, (b) the anticipated future effects or outcomes of service delivery programs undertaken during the reporting period, and (c) prospective financial and non-financial information. It may not be possible to verify the accuracy of all quantitative representations and explanations of such information until a future period, if at all.

3.31 To help assure users that prospective financial and non-financial quantitative information and explanations included in GPFRs faithfully represents the economic and other phenomena that they purport to represent, the assumptions that underlie the information disclosed, the methodologies adopted in compiling that information, and the factors and circumstances that support any opinions expressed or disclosures made should be transparent. This will enable users to form judgments about the appropriateness of those assumptions and the method of compilation, measurement, representation and interpretation of the information.

Constraints on Information Included in General Purpose Financial Reports

Materiality

3.32 Information is material if its omission or misstatement could influence the discharge of accountability by the entity, or the decisions that users make on the basis of the entity's GPFRs prepared for that reporting period. Materiality depends on both the nature and amount of the item judged in the particular circumstances of each entity. GPFRs may encompass qualitative and quantitative information about service delivery achievements during the reporting period, and expectations about service delivery and financial outcomes in the future. Consequently, it is not possible to specify a uniform quantitative threshold at which a particular type of information becomes material.

3.33 Assessments of materiality will be made in the context of the legislative, institutional and operating environment within which the entity operates and, in respect of prospective financial and non-financial information, the preparer's knowledge and expectations about the future. Disclosure of information about compliance or non-compliance with legislation, regulation or other authority may be material because of its nature—irrespective of the magnitude of any amounts involved. In determining whether an item is material in these circumstances, consideration will be given to such matters as the nature, legality, sensitivity and consequences of past or anticipated transactions and events, the parties involved in any such transactions and the circumstances giving rise to them.

3.34 Materiality is classified as a constraint on information included in GPFRs in the Conceptual Framework. In developing IPSASs and RPGs, the IPSASB will consider the materiality of the consequences of application of a particular accounting policy, basis of preparation or disclosure of a particular item or type of information. Subject to the requirements of any IPSAS, entities preparing GPFRs will also consider the materiality of, for example, the application of a particular accounting policy and the separate disclosure of particular items of information.

Cost-Benefit

3.35 Financial reporting imposes costs. The benefits of financial reporting should justify those costs. Assessing whether the benefits of providing information justify the related costs is often a matter of judgment, because it is often not possible to identify and/or quantify all the costs and all the benefits of information included in GPFRs.

3.36 The costs of providing information include the costs of collecting and processing the information, the costs of verifying it and/or presenting the assumptions and methodologies that support it, and the costs of disseminating it. Users incur the costs of analysis and interpretation. Omission of useful information also imposes costs, including the costs that users incur to obtain needed information from other sources and the costs that result from making decisions using incomplete data provided by GPFRs.

3.37 Preparers expend the majority of the effort to provide information in GPFRs. However, service recipients and resource providers ultimately bear the cost of those efforts—because resources are redirected from service delivery activities to preparation of information for inclusion in GPFRs.

3.38 Users reap the majority of benefits from the information provided by GPFRs. However, information prepared for GPFRs may also be used internally by management and result in better decision making by management. The disclosure of information in GPFRs consistent with the concepts identified in the Conceptual Framework and IPSASs and RPGs derived from them will enhance and reinforce perceptions of the transparency of financial reporting by governments and other public sector entities and contribute to the more accurate pricing of public sector debt. Therefore, public sector entities may also benefit in a number of ways from the information provided by GPFRs.

3.39 Application of the cost-benefit constraint involves assessing whether the benefits of reporting information are likely to justify the costs incurred to provide and use the information. When making this assessment, it is necessary to consider whether one or more qualitative characteristic might be sacrificed to some degree to reduce cost.

3.40 In developing IPSASs, the IPSASB considers information from preparers, users, academics, and others about the expected nature and quantity of the benefits and costs of the proposed requirements. Disclosure and other requirements which result in the presentation of information useful to users of GPFRs for accountability and decision-making purposes and satisfy the qualitative characteristics are prescribed by IPSASs when the benefits of compliance with those disclosures and other requirements are assessed by the IPSASB to justify their costs.

Balance Between the Qualitative Characteristics

3.41 The qualitative characteristics work together to contribute to the usefulness of information. For example, neither a depiction that faithfully represents an irrelevant phenomenon, nor a depiction that unfaithfully represents a relevant phenomenon, results in useful information. Similarly, to be relevant, information must be timely and understandable.

3.42 In some cases, a balancing or trade-off between qualitative characteristics may be necessary to achieve the objectives of financial reporting. The relative importance of the qualitative characteristics in each situation is a matter of professional judgment. The aim is to achieve an appropriate balance among the characteristics in order to meet the objectives of financial reporting.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Qualitative Characteristics of Information Included in General Purpose Financial Reports

BC3.1 In developing IPSASs, the IPSASB receives input from constituents on, and makes judgments about, information that best satisfies the objectives of financial reporting and should be included in GPFRs. In making those judgments, the IPSASB considers the extent to which each of the qualitative characteristics can be achieved. Disclosure and other requirements are included in IPSASs only when the information that results from their application is considered to satisfy the qualitative characteristics and the cost-benefit constraint identified in the Conceptual Framework.

BC3.2 Some respondents to the Exposure Draft expressed concern about the application of the qualitative characteristics to all matters that may be presented in GPFRs, particularly those matters that may be presented in reports outside the financial statements. The IPSASB understands this concern. The IPSASB acknowledges that IPSASs and RPGs that deal with the presentation in GPFRs of information outside the financial statements may need to include additional guidance on the application of the qualitative characteristics to the matters dealt with.

BC3.3 IPSASs and RPGs issued by the IPSASB will not deal with all financial and non-financial information that may be included in GPFRs. In the absence of an IPSAS or RPG that deals with particular economic or other phenomena, assessments of whether an item of information satisfies the qualitative characteristics and constraints identified in the Conceptual Framework, and therefore qualifies for inclusion in GPFRs, will be made by preparers compiling the GPFRs. Those assessments will be made in the context of achieving the objectives of financial reporting, which in turn have been developed to respond to users' information needs.

BC3.4 Having in place accounting systems and processes that are appropriately designed and are operated effectively will enable management to gather and process evidence to support financial reporting. The quality of these systems and processes is a key factor in ensuring the quality of financial information that the entity includes in GPFRs.

Other Qualitative Characteristics Considered

BC3.5 Some respondents to the Exposure Draft expressed the view that additional qualitative characteristics should be identified. Those qualitative characteristics included "sincerity," "true and fair view," "credibility," "transparency," and "regularity".

BC3.6 The IPSASB notes that "sincerity" as used in financial reporting has a similar meaning to "true and fair". The IPSASB is of the view that sincerity, true and fair view, credibility, and transparency are important expressions of the overarching qualities that financial reporting is to achieve or aspire to. However, they do not exist as single qualitative characteristics on their own—rather, achieving these qualities is the product of application of the full set of qualitative characteristics identified in the Conceptual Framework, and the IPSASs that deal with specific reporting issues. Consequently, while important characteristics of GPFRs, they are not identified as separate individual qualitative characteristics in their own right. The IPSASB is also of the view that the notion of "regularity" as noted by some respondents is related to the notion of "compliance" as used in the Conceptual Framework—therefore, regularity is not identified as an additional qualitative characteristic.

Relevance

BC3.7 The Conceptual Framework explains that financial and non-financial information is relevant if it is capable of making a difference in achieving the objectives of financial reporting. As part of its due process the IPSASB seeks input on whether the requirements of a proposed IPSAS or any proposed RPGs are relevant to the achievement of the objectives of financial reporting—that is, are relevant to the discharge of the entity's obligation to be accountable and to decisions that users may make.

Faithful Representation

BC3.8 The Conceptual Framework explains that to be useful information must be a faithful representation of the economic and other phenomena that it purports to represent. A single economic or other phenomenon may be faithfully represented in many ways. For example, the achievement of particular service delivery objectives may be depicted (a) qualitatively through an explanation of the immediate and anticipated longer term outcomes and effects of the service delivery program, (b) quantitatively as a measure of the volume and cost of services provided by the service delivery program, or (c) by a combination of both qualitative and quantitative information. Additionally, a single depiction in GPFRs may represent several economic phenomena. For example, the presentation of the item "plant and equipment" in a financial statement may represent an aggregate of all of an entity's plant and equipment, including items that have different functions, that are subject to different risks and opportunities and that are carried at amounts based on estimates that may be more or less complex and reliable.

BC3.9 Completeness and neutrality of estimates (and inputs to those estimates) and freedom from material error are desirable, and some minimum level of accuracy is necessary for an estimate to faithfully represent an economic or other phenomenon. However, faithful representation does not imply absolute completeness or neutrality in the estimate, nor does it imply total freedom from error in the outcome. For a representation of an economic or other phenomenon to imply a degree of completeness, neutrality, or freedom from error that is impracticable for it to achieve would diminish the extent to which the information faithfully represents the economic or other phenomenon that it purports to represent.

Faithful Representation or Reliability

BC3.10 At the time of issue of the Exposure Draft, Appendix A of IPSAS 1, *Presentation of Financial Statements* identified "reliability" as a qualitative characteristic. It described reliable information as information that 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, substance over form, neutrality, prudence and completeness were identified as components of reliability. The Conceptual Framework uses the term "faithful representation" rather than "reliability" to describe what is substantially the same concept. In addition, it does not explicitly identify substance over form and prudence as components of faithful representation.

BC3.11 Many respondents to the Exposure Draft supported the use of faithful representation and its explanation in the Exposure Draft, in some cases explaining that faithful representation is a better expression of the nature of the concept intended. Some respondents did not support the replacement of reliability with the term faithful representation, expressing concerns including that faithful representation implies the adoption of fair value or market value accounting, and reliability and faithful representation are not interchangeable terms.

BC3.12 The use of the term "faithful representation", or "reliability" for that matter, to describe this qualitative characteristic in the Conceptual Framework will not determine the measurement basis to be adopted in GPFRs, whether historical cost, market value, fair value or another measurement basis. The IPSASB does not intend that use of faithful representation be interpreted as such. The measurement basis or measurement bases that may be adopted for the elements of financial statements are considered in Chapter 7, *Measurement of Assets and Liabilities in Financial Statements*. The qualitative characteristics will then operate to ensure that the financial statements faithfully represent the measurement basis or bases reflected in GPFRs.

BC3.13 The IPSASB appreciates the concern of some respondents that the use of a different term may be interpreted to reflect different, and even lesser, qualities to those communicated by the term reliability. However, the IPSASB is of the view that explanation in the Framework that "Faithful representation is attained when the depiction of the phenomenon is complete, neutral, and free from material error", and the elaboration of these key features will protect against the loss of any of the qualities that were formerly reflected in the use of the term reliability.

BC3.14 In addition, the IPSASB has been advised that the term "reliability" is itself open to different interpretations and subjective judgments, with consequences for the quality of information included in GPFRs. The IPSASB is of the view that use of the term "faithful representation" will overcome problems in the interpretation and application of reliability that have been experienced in some jurisdictions without a lessening of the qualities intended by the term, and is more readily translated into, and understood in, a wide range of languages.

Substance over Form and Prudence

BC3.15 Some respondents to the Exposure Draft expressed concern that substance over form and prudence are not identified as qualitative characteristics or that their importance is not sufficiently recognized or explained. Some also noted that prudence need not be incompatible with the achievement of neutrality and faithful representation.

BC3.16 The Conceptual Framework explains that "Information that faithfully represents an economic or other phenomenon depicts the substance of the underlying transaction, other event, activity or circumstance—which is not necessarily always the same as its legal form." Therefore substance over form remains a key quality that information included in GPFRs must possess. It is not identified as a separate or additional qualitative characteristic because it is already embedded in the notion of faithful representation.

BC3.17 The IPSASB is of the view that the notion of prudence is also reflected in the explanation of neutrality as a component of faithful representation, and the acknowledgement of the need to exercise caution in dealing with uncertainty. Therefore, like substance over form, prudence is not identified as a separate qualitative characteristic because its intent and influence in identifying information that is included in GPFRs is already embedded in the notion of faithful representation.

Understandability

BC3.18 Although presenting information clearly and concisely helps users to comprehend it, the actual comprehension or understanding of information depends largely on the users of the GPFRs.

BC3.19 Some economic and other phenomena are particularly complex and difficult to represent in GPFRs. However, the IPSASB is of the view that information that is, for example, relevant, a faithful representation of what it purports to represent, timely and verifiable should not be excluded from GPFRs solely because it may be too complex or difficult for some users to understand without assistance. Acknowledging that it may be necessary for some users to seek assistance to understand the information presented in GPFRs does not mean that information included in GPFRs need not be understandable or that all efforts should not be undertaken to present information in GPFRs in a manner that is understandable to a wide range of users. However, it does reflect that, in practice, the nature of the information included in GPFRs is such that all the qualitative characteristics may not be fully achievable at all times for all users.

Timeliness

BC3.20 The IPSASB recognizes the potential for timely reporting to increase the usefulness of GPFRs for both accountability and decision-making purposes, and that undue delay in the provision of information may reduce its usefulness for these purposes. Consequently, timeliness is identified as a qualitative characteristic in the Conceptual Framework.

Comparability

BC3.21 Some degree of comparability may be attained by maximizing the qualitative characteristics of relevance and faithful representation. For example, faithful representation of a relevant economic or other phenomenon by one public sector entity is likely to be comparable to a faithful representation of a similar relevant economic or other phenomenon by another public sector entity. However, a single economic or other phenomenon can often be faithfully represented in several ways, and permitting alternative accounting methods for the same phenomenon diminishes comparability and, therefore, may be undesirable.

BC3.22 Some respondents to the Exposure Draft expressed concern that the explanation of the relationship between comparability and consistency may be read as presenting an obstacle to the on-going development of financial reporting. This is because enhancements in financial reporting often involve a revision or change to the accounting principles, policies or basis of preparation currently adopted by the entity.

BC3.23 Consistent application of the same accounting principles, policies and basis of preparation from one period to the next will assist users in assessing the financial position, financial performance and service delivery achievements of the entity compared with previous periods. However, where accounting principles or policies dealing with particular transactions or other events are not prescribed by IPSASs, achievement of the qualitative characteristic of comparability should not be interpreted as prohibiting the entity from changing its accounting principles or policies to better represent those transactions and events. In these cases, the inclusion in GPFRs of additional disclosures or explanation of the impact of the changed policy can still satisfy the characteristics of comparability.

Verifiability

BC3.24 Verifiability is the quality of information that helps assure users that information in GPFRs faithfully represents the economic and other phenomena that it purports to represent. While closely linked to faithful representation, verifiability is identified as a separate qualitative characteristic because information may faithfully represent economic and other phenomena even though it cannot be verified with absolute certainty. In addition, verifiability may work in different ways with faithful representation and other of the qualitative characteristics to contribute to the usefulness of information presented in GPFRs—for example, there may need to be an appropriate balance between the degree of verifiability an item of information may possess and other qualitative characteristics to ensure it is presented in a timely fashion and is relevant.

BC3.25 In developing the qualitative characteristics identified in the Framework, the IPSASB considered whether "supportability" should be identified as a separate characteristic for application to information presented in GPFRs outside the financial statements. The IPSASB is of the view that identifying both verifiability and supportability as separate qualitative characteristics with essentially the same features may be confusing to preparers and users of GPFRs and others. However, the Conceptual Framework does acknowledge that supportability is sometimes used to refer to the quality of information that helps assure users that explanatory information and prospective financial and non-financial information included in GPFRs faithfully represent the economic and other phenomena that they purport to represent.

BC3.26 Some respondents to the Exposure Draft expressed concern about the application of verifiability to the broad range of matters that may be presented in GPFRs outside the financial statements, particularly explanatory information about service delivery achievements during the reporting period and qualitative and quantitative prospective financial and non-financial information. The IPSASB is of the view that the Conceptual Framework provides appropriate guidance on the application of verifiability in respect of these matters—for example it explains that verifiability is not an absolute and it may not be possible to verify the accuracy of all quantitative representations and explanations until a future period. The Framework also acknowledges that disclosure of the underlying assumptions and methodologies adopted for the compilation of explanatory and prospective financial and non-financial information is central to the achievement of faithful representation.

Classification of the Qualitative Characteristics and Order of their Application

BC3.27 Some respondents to the Exposure Draft expressed the view that the Conceptual Framework should identify:

- Relevance and faithful representation as fundamental qualitative characteristics, and explain the order of their application; and
- Comparability, verifiability, timeliness, and understandability as enhancing qualitative characteristics.

They noted that this would provide useful guidance on the sequence of application of the qualitative characteristics and reflect the approach adopted by the International Accounting Standards Board.

BC3.28 In developing the qualitative characteristics, the IPSASB considered whether some characteristics should be identified as fundamental and others identified as enhancing. The IPSASB also considered whether the order of application of the characteristics should be identified and/or explained. The IPSASB is of the view that such an approach should not be adopted because, for example:

- Matters identified as “fundamental” may be perceived to be more important than those identified as “enhancing”, even if this distinction is not intended in the case of the qualitative characteristics. As a result, there may be unintended consequences of identifying some qualitative characteristics as fundamental and others as enhancing;
- All the qualitative characteristics are important and work together to contribute to the usefulness of information. The relative importance of a particular qualitative characteristic in different circumstances is a matter of professional judgment. As such, it is not appropriate to identify certain qualitative characteristics as always being fundamental and others as having only an enhancing or supporting role, or to specify the sequence of their application, no matter what information is being considered for inclusion in GPFRs, and irrespective of the circumstances of the entity and its environment. In addition, it is questionable whether information that is not understandable or is provided so long after the event as not to be useful to users for accountability and decision-making purposes could be considered as relevant information—therefore, these characteristics are themselves fundamental to the achievement of the objectives of financial reporting; and
- GPFRs of public sector entities may encompass historical and prospective information about financial performance and the achievement of service delivery objectives over a number of reporting periods. This provides necessary input to assessments of trends in service delivery activities and resources committed thereto—for such

trend data, reporting on a comparable basis may be as important as, and cannot be separated from, faithful representation of the information.

Constraints on Information Included in General Purpose Financial Reports

Materiality

BC3.29 At the time of issue of the Exposure Draft, Appendix A of IPSAS 1 described materiality with similar characteristics to that described in the Conceptual Framework, but identified materiality as a factor to be considered in determining only the relevance of information. Some respondents to the Exposure Draft noted that materiality may be identified as an aspect of relevance.

BC3.30 The IPSASB has considered whether materiality should be identified as an entity-specific aspect of relevance rather than a constraint on information included in GPFRs. As explained in the Conceptual Framework, and subject to requirements in an IPSAS, materiality will be considered by preparers in determining whether, for example, a particular accounting policy should be adopted or an item of information should be separately disclosed in the financial statements of the entity.

BC3.31 However, the IPSASB is of the view that materiality has a more pervasive role than would be reflected by its classification as only an entity specific aspect of relevance. For example, materiality relates to, and can impact, a number of the qualitative characteristics of information included in GPFRs. Therefore, the materiality of an item should be considered when determining whether the omission or misstatement of an item of information could undermine not only the relevance, but also the faithful representation, understandability or verifiability of financial and non-financial information presented in GPFRs. The IPSASB is also of the view that whether the effects of the application of a particular accounting policy or basis of preparation or the information content of separate disclosure of certain items of information are likely to be material should be considered in establishing IPSASs and RPGs. Consequently, the IPSASB is of the view that materiality is better reflected as a broad constraint on information to be included in GPFRs.

BC3.32 The IPSASB considered whether the Conceptual Framework should reflect that legislation, regulation or other authority may impose financial reporting requirements on public sector entities in addition to those imposed by IPSASs. The IPSASB is of the view that, while a feature of the operating environment of many public sector (and many private sector) entities, the impact that legislation or other authority may have on the information included in GPFRs is not itself a financial reporting concept. Consequently, it has not identified it as such in the Conceptual Framework. Preparers will, of course, need to consider such requirements as they prepare GPFRs. In particular, legislation may prescribe that particular items of information are to be disclosed in GPFRs even though they may not be judged to satisfy a materiality threshold (or cost-benefit constraint) as identified in the Conceptual Framework. Similarly, the disclosure of some matters may be prohibited by legislation because, for example, they relate to matters of national security, notwithstanding that they are material and would otherwise satisfy the cost-benefit constraint.

Cost-Benefit

BC3.33 Some respondents to the Exposure Draft expressed concern that the text of the proposed Conceptual Framework does not specify that entities cannot decide to depart from IPSASs on the basis of their own assessments of the costs and benefits of particular requirements of an IPSAS. The IPSASB is of the view that such specification is not necessary. This is because, as noted in Paragraph 1.2 of the Conceptual Framework, authoritative requirements relating to recognition, measurement, and presentation in GPFRs are specified in IPSASs. GPFRs are developed to provide information useful to users and requirements are prescribed by IPSASs only when the benefits to users of compliance with those requirements are assessed by the IPSASB to justify their costs. However, preparers may consider costs and benefits in, for example, determining whether to include in GPFRs disclosure of information in addition to that required by IPSASs.

BC3.34 Some respondents to the Exposure Draft also expressed concern that the proposed Conceptual Framework did not recognize that cost-benefit trade-offs may differ for different public sector entities. They are of the view that acknowledgement of this may provide a useful principle to be applied when considering differential reporting issues. The IPSASB has considered these matters and determined that the Conceptual Framework will not deal with issues related to differential reporting, including whether the costs and benefits of particular requirements might differ for different entities.

BC3.35 In the process of developing an IPSAS or RPG, the IPSASB considers and seeks input on the likely costs and benefits of providing information in GPFRs of public sector entities. However, in some cases, it may not be possible for the IPSASB to identify and/or quantify all benefits that are likely to flow from, for example, the inclusion of a particular disclosure, including those that may be required because they are in the public interest, or other requirement in an IPSAS. In other cases, the IPSASB may be of the view that the benefits of a particular requirement may be marginal for users of GPFRs of some public sector entities. In applying the cost-benefit test to determine whether particular requirements should be included in an IPSAS in these circumstances, the IPSASB's deliberations may also include consideration of whether imposing such requirements on public sector entities is likely to involve undue cost and effort for the entities applying the requirements.

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CHAPTER 4: REPORTING ENTITY

CONTENTS

Introduction

4.1 A public sector reporting entity is a government or other public sector organization, program or identifiable area of activity (hereafter referred to as an entity or public sector entity) that prepares GPFRs.

4.2 A public sector reporting entity may comprise two or more separate entities that present GPFRs as if they are a single entity—such a reporting entity is referred to as a group reporting entity.

Key Characteristics of a Reporting Entity

4.3 Key characteristics of a public sector reporting entity are that:

- It is an entity that raises resources from, or on behalf of, constituents and/or uses resources to undertake activities for the benefit of, or on behalf of, those constituents; and
- There are service recipients or resource providers dependent on GPFRs of the entity for information for accountability or decision-making purposes.

4.4 A government may establish and/or operate through administrative units such as ministries or departments. It may also operate through trusts, statutory authorities, government corporations and other entities with a separate legal identity or operational autonomy to undertake or otherwise support the provision of services to constituents. Other public sector organizations, including international public sector organizations and municipal authorities, may also undertake certain activities through, and may benefit from and be exposed to a financial burden or loss as a result of, the activities of entities with a separate legal identity or operational autonomy.

4.5 GPFRs are prepared to report information useful to users for accountability and decision-making purposes. Service recipients and resource providers are the primary users of GPFRs. Consequently, a key characteristic of a reporting entity, including a group reporting entity, is the existence of service recipients or resource providers who are dependent on GPFRs of that entity or group of entities for information for accountability or decision-making purposes.

4.6 GPFRs encompass financial statements and information that enhances, complements and supplements the financial statements. Financial statements present information about the resources of the reporting entity or group reporting entity and claims to those resources at the reporting date, and changes to those resources and claims and cash flows during the reporting period. Therefore, to enable the preparation of financial statements, a reporting entity will raise resources and/or use resources previously raised to undertake activities for the benefit of, or on behalf of, its constituents.

4.7 The factors that are likely to signal the existence of users of GPFRs of a public sector entity or group of entities include an entity having the responsibility or capacity to raise or deploy resources, acquire or manage public assets, incur liabilities, or undertake activities to achieve service delivery objectives. The greater the resources that a public sector entity raises, manages and/or has the capacity to deploy, the greater the liabilities it incurs and the greater the economic or social impact of its activities, the more likely it is that there will exist service recipients or resource providers who are dependent on GPFRs for information about it for accountability and decision-making purposes. In the absence of these factors, or where they are not significant, it is unlikely that users of GPFRs of these entities will exist.

4.8 The preparation of GPFRs is not a cost-free process. Therefore, if the imposition of financial reporting requirements is to be efficient and effective, it is important that only those public sector entities for which such users exist are required to prepare GPFRs.

4.9 In many cases, it will be clear whether or not there exist service recipients or resource providers that are dependent on GPFRs of a public sector entity for information for accountability and decision-making purposes. For example, such users are likely to exist for GPFRs of a government at the national, state or local government level and for international public sector organizations. This is because these governments and organizations generally have the capacity to raise substantial resources from and/or deploy substantial resources on behalf of their constituents, to incur liabilities, and to impact the economic and/or social well-being of the communities that depend on them for the provision of services.

4.10 However, it may not always be clear whether there are service recipients or resource providers that are dependent on GPFRs of, for example, individual government departments and agencies, particular programs or identifiable areas of activity for information for accountability and decision-making purposes. Determining whether these organizations, programs or activities should be identified as reporting entities and, consequently, be required to prepare GPFRs will involve the exercise of professional judgment.

4.11 The government and some other public sector entities have a separate identity or standing in law (a legal identity). However, public sector organizations, programs and activities without a separate legal identity may also raise or deploy resources, acquire or manage public assets, incur liabilities, undertake activities to achieve service delivery objectives or otherwise implement government policy. Service recipients and resource providers may depend on GPFRs of these organizations, programs and activities for information for accountability and decision-making purposes. Consequently, a public sector reporting entity may have a separate legal identity or be, for example, an organization, administrative arrangement or program without a separate legal identity.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Key Characteristics of a Reporting Entity

BC4.1 The concept of the reporting entity is derived from the objectives of financial reporting by public sector entities. The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of GPFRs for accountability and decision-making purposes.

BC4.2 Reporting entities prepare GPFRs. GPFRs include financial statements, which present information about such matters as the financial position, performance and cash flows of the entity, and financial and non-financial information that enhances, complements and supplements the financial statements. Therefore, a key characteristic of a public sector reporting entity is the existence of service recipients or resource providers who are dependent on GPFRs of a government or other public sector entity for information for accountability or decision-making purposes.

Legislation, Regulation or Other Authority

BC4.3 The Exposure Draft did not specify which public sector entities should be identified as a reporting entity or group reporting entity and, therefore, be required to prepare GPFRs. It noted that the public sector organizations and programs that are to prepare GPFRs will be specified in legislation, regulation or other authority, or be determined by relevant authoritative bodies in each jurisdiction.

BC4.4 Some respondents expressed the view that while legislation or other authority may, in practice, specify which entities are to prepare GPFRs, the Conceptual Framework should focus on the concept of the reporting entity, identify key features of that concept and provide guidance on the principles and factors that should be considered in determining whether a reporting entity exists. The IPSASB was persuaded by these arguments and has refocused its discussion on an explanation of the concept of the reporting entity.

Interpretation and Application

BC4.5 Some respondents expressed concern that the characteristics of a reporting entity as explained in the Exposure Draft may be interpreted to identify particular activities or segments of an organization as separate reporting entities. These segments or activities would then be required to prepare GPFRs in accordance with all IPSASs. Some respondents also noted that it was not clear how the guidance in the Exposure Draft applied to public sector organizations other than governments including, for example, international public sector organizations.

BC4.6 The IPSASB has responded to these concerns. The Framework explains that preparation of GPFRs is not a cost-free process. It also:

- Includes additional guidance on the factors that are likely to signal the existence of service recipients or resource providers who are dependent on GPFRs of a government or other public sector entity for information for accountability or decision-making purposes; and
- Notes the likely implications of these factors for the identification of a range of public sector organizations, programs and activities as reporting entities, including government departments and agencies and international public sector organizations.

BC4.7 The Conceptual Framework acknowledges that in some cases it may be necessary to exercise professional judgment in determining whether particular public sector entities should be identified as a reporting entity. In exercising that judgement, it should be noted that, in certain circumstances, IPSASs respond to users' needs for information about particular programs or activities undertaken by a government or other public sector reporting entity by providing for separate disclosures within the GPFRs of that government or other public sector reporting entity[5]. Jurisdictional factors such as the legislative and regulatory framework in place and institutional and administrative arrangements for the raising of resources and the delivery of services are also likely to inform deliberations on whether it is likely that service recipients and resource providers dependent on GPFRs of particular public sector entities exist.

The Group Reporting Entity

BC4.8 The Exposure Draft outlined the circumstances that would justify the inclusion of an entity or activity within a public sector group reporting entity. It explained that:

- A government or other public sector entity may (a) have the authority and capacity to direct the activities of one or more other entities so as to benefit from the activities of those entities, and (b) be exposed to a financial burden or loss that may arise as a result of the activities of those entities; and
- To satisfy the objectives of financial reporting, GPFRs of a group reporting entity prepared in respect of a government or other public sector entity should include that government (or other public sector entity) and the entities whose activities it has the authority and capacity to direct, when the results of such direction can (a) generate

5 For example, International Public Sector Accounting Standards (IPSASs) such as IPSAS 18, *Segment Reporting* and IPSAS 22, *Disclosure of Financial Information about the General Government Sector* provide a mechanism to satisfy users' need for information about particular segments or sectors of an entity without their identification as separate reporting entities.

financial or other benefits for the government (or other public sector entity), or (b) expose it to a financial burden or loss.

BC4.9 Many respondents to the Exposure Draft noted their agreement with the IPSASB's view of the criteria that should be satisfied for inclusion in a public sector group reporting entity. However, other respondents expressed their concern about the potential interpretation and application of the criteria in particular circumstances. In some cases, they noted that the Framework would need to provide additional application guidance if it was to be effective in dealing with circumstances not dealt with in IPSASs. A number of respondents also expressed the view that the criteria to be satisfied for inclusion in a group reporting entity were more appropriately addressed and resolved at the standards level, where those criteria and their consequences could be tested across a range of circumstances, and supported with specific examples of the circumstances likely to exist in many jurisdictions.

BC4.10 The IPSASB found these concerns persuasive. It has reconstructed and drawn together its discussion of the reporting entity and group reporting entity to focus on the principles underlying the identification of a public sector reporting entity—whether that reporting entity comprises a single public sector entity or a group of entities. The identification of the criteria to be satisfied for inclusion in a group reporting entity consistent with these principles will then be developed and fully explored at the standards level.

CHAPTER 5: ELEMENTS IN FINANCIAL STATEMENTS

CONTENTS

Introduction

Purpose of this Chapter

5.1 This Chapter defines the elements used in financial statements and provides further explanation about those definitions.

Elements and their Importance

5.2 Financial statements portray the financial effects of transactions and other events by grouping them into broad classes which share common economic characteristics. These broad classes are termed the elements of financial statements. Elements are the building blocks from which financial statements are constructed. These building blocks provide an initial point for recording, classifying and aggregating economic data and activity in a way that provides users with information that meets the objectives of financial reporting and achieves the qualitative characteristics of financial reporting while taking into account the constraints on information included in GPFRs.

5.3 The elements defined in this Chapter do not refer to the individual items that are recognized as a result of transactions and events. Sub-classifications of individual items within an element and aggregations of items are used to enhance the understandability of the financial statements. Presentation is addressed in Chapter 8, *Presentation in General Purpose Financial Reports.*

5.4 In some circumstances, to ensure that the financial statements provide information that is useful for a meaningful assessment of the financial performance and financial position of an entity, recognition of economic phenomena that are not captured by the elements as defined in this Chapter may be necessary. Consequently, the identification of the elements in this Chapter does not preclude IPSASs from requiring or allowing the recognition of resources or obligations that do not satisfy the definition of an element identified in this Chapter (hereafter referred to as “other resources” or “other obligations”) when necessary to better achieve the objectives of financial reporting.

Elements Defined

5.5 The elements that are defined in this Chapter are:

- Assets;
- Liabilities;
- Revenue;
- Expense;
- Ownership contributions; and
- Ownership distributions.

Assets

Definition

5.6 An asset is:

A resource presently controlled by the entity as a result of a past event.

A Resource

5.7 A resource is an item with service potential or the ability to generate economic benefits. Physical form is not a necessary condition of a resource. The service potential or ability to generate economic benefits can arise directly from the resource itself or from the rights to use the resource. Some resources embody an entity's rights to a variety of benefits including, for example, the right to:

- Use the resource to provide services[6];
- Use an external party's resources to provide services, for example, leases;
- Convert the resource into cash through its disposal;
- Benefit from the resource's appreciation in value; or
- Receive a stream of cash flows.

5.8 Service potential is the capacity to provide services that contribute to achieving the entity's objectives. Service potential enables an entity to achieve its objectives without necessarily generating net cash inflows.

5.9 Public sector assets that embody service potential may include recreational, heritage, community, defense and other assets which are held by governments and other public sector entities, and which are used to provide services to third parties. Such services may be for collective or individual consumption. Many services may be provided in areas where there is no market competition or limited market competition. The use and disposal of such assets may be restricted as many assets that embody service potential are specialized in nature.

5.10 Economic benefits are cash inflows or a reduction in cash outflows. Cash inflows (or reduced cash outflows) may be derived from, for example:

- An asset's use in the production and sale of services; or
- The direct exchange of an asset for cash or other resources;

Presently Controlled by the Entity

5.11 An entity must have control of the resource. Control of the resource entails the ability of the entity to use the resource (or direct other parties on its use) so as

6 References to "services" in the Conceptual Framework encompass "goods".

to derive the benefit of the service potential or economic benefits embodied in the resource in the achievement of its service delivery or other objectives.

5.12 In assessing whether it presently controls a resource, an entity assesses whether the following indicators of control exist:

- Legal ownership;
- Access to the resource, or the ability to deny or restrict access to the resource;
- The means to ensure that the resource is used to achieve its objectives; and
- The existence of an enforceable right to service potential or the ability to generate economic benefits arising from a resource.

While these indicators are not conclusive determinants of whether control exists, identification and analysis of them can inform that decision.

Past Event

5.13 The definition of an asset requires that a resource that an entity presently controls must have arisen from a past transaction or other past event. The past transactions or other events that result in an entity gaining control of a resource and therefore an asset may differ. Entities can obtain assets by purchasing them in an exchange transaction or developing them. Assets may also arise through non-exchange transactions, including through the exercising of sovereign powers. The power to tax or to issue licenses and to access or restrict or deny access to the benefits embodied in intangible resources, like the electromagnetic spectrum, are examples of public sector-specific powers and rights that may give rise to assets. In assessing when an entity's control of rights to resources arise the following events may be considered: (a) a general ability to establish a power, (b) establishment of a power through a statute, (c) exercising the power to create a right, and (d) the event which gives rise to the right to receive resources from an external party. An asset arises when the power is exercised and the rights exist to receive resources.

Liabilities

Definition

5.14 A liability is:

A present obligation of the entity for an outflow of resources that results from a past event.

A Present Obligation

5.15 Public sector entities can have a number of obligations. A present obligation is a legally binding obligation (legal obligation) or non-legally binding obligation, which an entity has little or no realistic alternative to avoid. Obligations are not present obligations unless they are binding and there is little or no realistic alternative to avoid an outflow of resources.

An Outflow of Resources from the Entity

5.16 A liability must involve an outflow of resources from the entity for it to be settled. An obligation that can be settled without an outflow of resources from the entity is not a liability.

Past Event

5.17 To satisfy the definition of a liability, it is necessary that a present obligation arises as a result of a past transaction or other event and requires an outflow of resources from the entity. The complexity of public sector programs and activities means that a number of events in the development, implementation and operation of a particular program may give rise to obligations. For financial reporting purposes it is necessary to determine whether such commitments and obligations, including binding obligations that the entity has little or no realistic alternative to avoid but are not legally enforceable (non-legally binding obligations) are present obligations and satisfy the definition of a liability. Where an arrangement has a legal form and is binding, such as a contract, the past event may be straightforward to identify. In other cases, it may be more difficult to identify the past event and identification involves an assessment of when an entity has little or no realistic alternative to avoid an outflow of resources from the entity. In making such an assessment an entity takes jurisdictional factors into account.

Legal and Non-Legally Binding Obligations

5.18 Binding obligations can be legal obligations or non-legally binding obligations. Binding obligations can arise from both exchange and non-exchange transactions. An obligation must be to an external party in order to give rise to a liability. An entity cannot be obligated to itself, even where it has publicly communicated an intention to behave in a particular way. Identification of an external party is an indication of the existence of an obligation giving rise to a liability. However, it is not essential to know the identity of the external party before the time of settlement in order for a present obligation and a liability to exist.

5.19 Many arrangements that give rise to an obligation include settlement dates. The inclusion of a settlement date may provide an indication that an obligation involves an outflow of resources and gives rise to a liability. However, there are many agreements that do not contain settlement dates. The absence of a settlement date does not preclude an obligation giving rise to a liability.

Legal Obligations

5.20 A legal obligation is enforceable in law. Such enforceable obligations may arise from a variety of legal constructs. Exchange transactions are usually contractual in nature and therefore enforceable through the laws of contract or equivalent authority or arrangements. There are jurisdictions where government and public sector entities cannot enter into legal obligations, because, for example, they are not permitted to contract in their own name, but where there are alternative processes with equivalent effect. Obligations that are binding through such alternative processes are considered legal obligations in the Conceptual Framework. For some types of non-exchange transactions, judgment will be necessary to determine whether an obligation is enforceable in law. Where it is determined that an obligation is enforceable in law there can be no doubt that an entity has no realistic alternative to avoid the obligation and that a liability exists.

5.21 Some obligations related to exchange transactions are not strictly enforceable by an external party at the reporting date, but will be enforceable with the passage of time without the external party having to meet further conditions—or having to take any further action—prior to settlement. Claims that are unconditionally enforceable subject to the passage of time are enforceable obligations in the context of the definition of a liability.

5.22 Sovereign power is the ultimate authority of a government to make, amend and repeal legal provisions. Sovereign power is not a rationale for concluding that an obligation does not meet the definition of a liability in this Framework. The legal position should be assessed at each reporting date to consider if an obligation is no longer binding and does not meet the definition of a liability.

Non-Legally Binding Obligations

5.23 Liabilities can arise from non-legally binding obligations. Non-legally binding obligations differ from legal obligations in that the party to whom the obligation exists cannot take legal (or equivalent) action to enforce settlement. Non-legally binding obligations that give rise to liabilities have the following attributes:

- The entity has indicated to other parties by an established pattern of past practice, published policies, or a sufficiently specific current statement that it will accept certain responsibilities;
- As a result of such an indication, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities; and
- The entity has little or no realistic alternative to avoid settling the obligation arising from those responsibilities.

5.24 In the public sector, obligations may arise at a number of points. For example, in implementing a program or service:

- Making a political promise such as an electoral pledge;
- Announcement of a policy;
- Introduction (and approval) of the budget (which may be two distinct points); and
- The budget becoming effective (in some jurisdictions the budget will not be effective until an appropriation has been effected).
- The early stages of implementation are unlikely to give rise to present obligations that meet the definition of a liability. Later stages, such as claimants meeting the eligibility criteria for the service to be provided, may give rise to obligations that meet the definition of a liability.

5.25 The point at which an obligation gives rise to a liability depends on the nature of the obligation. Factors that are likely to impact on judgments whether other parties can validly conclude that the obligation is such that the entity has little or no realistic alternative to avoid an outflow of resources include:

- The nature of the past event or events that give rise to the obligation. For example, a promise made in an election is unlikely to give rise to a present obligation because an electoral pledge very rarely creates a valid expectation on the part of external parties that the entity has an obligation that it has little or no realistic alternative to avoid settling. However, an announcement in relation to an event or circumstance that has occurred may have such political support that the government has little option to withdraw. Where the government has committed to introduce and secure passage of the necessary budgetary provision such an announcement may give rise to a non-legally binding obligation;
- The ability of the entity to modify or change the obligation before it crystallizes. For example, the announcement of policy will generally not give rise to a non-legally binding obligation, which cannot be modified before being implemented. Similarly, if an obligation is contingent on future events occurring, there may be discretion to avoid an outflow of resources before those events occur; and
- There may be a correlation between the availability of funding to settle a particular obligation and the creation of a present obligation. For example, where both a budget line item has been approved and linked funding is assured through an appropriation, the availability of contingency funding or a transfer from a different level of government, a non-legally binding obligation may exist. However the absence of a budgetary provision does not itself mean that a present obligation has not arisen.

5.26 “Economic coercion”, “political necessity” or other circumstances may give rise to situations where, although the public sector entity is not legally obliged to incur an outflow of resources, the economic or political consequences of refusing to do so are such that the entity may have little or no realistic alternative to avoid an outflow of resources. Economic coercion, political necessity or other circumstances may lead to a liability arising from a non-legally binding obligation.

Net Financial Position, Other Resources, and Other Obligations

5.27 As explained in paragraph 5.4, in some cases, in developing or revising an IPSAS, the IPSASB may determine that to achieve the objectives of financial reporting a resource or obligation that does not satisfy the definition of an element defined in the Conceptual Framework needs to be recognized in the financial statements. In these cases, the IPSAS may require or allow these resources or obligations to be recognized as other resources or other obligations, which are items additional to the six elements defined in this Framework.

5.28 Net financial position is the difference between assets and liabilities after adding other resources and deducting other obligations recognized in the statement of financial position. Net financial position can be a positive or negative residual amount.

Revenue and Expense

Definitions

5.29 Revenue is:

Increases in the net financial position of the entity, other than increases arising from ownership contributions.

5.30 Expense is:

Decreases in the net financial position of the entity, other than decreases arising from ownership distributions.

5.31 Revenue and expense arise from exchange and non-exchange transactions, other events such as unrealized increases and decreases in the value of assets and liabilities, and the consumption of assets through depreciation and erosion of service potential and ability to generate economic benefits through impairments. Revenue and expense may arise from individual transactions or groups of transactions.

Surplus or Deficit for the Period

5.32 The entity's surplus or deficit for the period is the difference between revenue and expense reported on the statement of financial performance.

Ownership Contributions and Ownership Distributions

Definitions

5.33 Ownership contributions are:

Inflows of resources to an entity, contributed by external parties in their capacity as owners, which establish or increase an interest in the net financial position of the entity.

5.34 Ownership distributions are:

Outflows of resources from the entity, distributed to external parties in their capacity as owners, which return or reduce an interest in the net financial position of the entity.

5.35 It is important to distinguish inflows of resources from owners, including those inflows that initially establish the ownership interest, and outflows of resources to owners in their capacity as owners from revenue and expense. In addition to the injections of resources and the payment of dividends that may occur, in some jurisdictions it is relatively common for assets and liabilities to be transferred between public sector entities. Where such transfers satisfy the definitions of ownership contributions or ownership distributions they will be accounted for as such.

5.36 Ownership interests may arise on the creation of an entity when another entity contributes resources to provide the new entity with the capacity to commence operational activities. In the public sector, contributions to, and distributions from, entities are sometimes linked to the restructuring of government and will take the form of transfers of assets and liabilities rather than cash transactions. Ownership interests may take different forms, which may not be evidenced by an equity instrument.

5.37 Ownership contributions may take the form of an initial injection of resources at the creation of an entity or a subsequent injection of resources, including those where an entity is restructured. Ownership distributions may be: (a) a return on investment; (b) a full or partial return of investment; or (c) in the event of the entity being wound up or restructured, a return of any residual resources.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Scope of Chapter

BC5.1 Respondents to the Consultation Paper, *Elements and Recognition in Financial Statements* (the Consultation Paper), questioned why the IPSASB was only addressing elements for the financial statements in this phase of the Framework. They suggested that IPSASB should also develop elements for economic and other phenomena in the more comprehensive areas of financial reporting outside the financial statements. The IPSASB acknowledges the merits of these views and the need to develop such elements in the future. However, the IPSASB decided that in order to put its future standard-setting activities for the financial statements on a sound and transparent footing it is important to deal firstly with the development of elements for the financial statements.

BC5.2 The IPSASB acknowledges a view that cash inflows and cash outflows should be defined as elements of the cash flow statement. The IPSASB took the view that cash inflows and cash outflows are components of the elements identified in this Chapter, and that further guidance should be provided at standards level.

Assets

A Resource

BC5.3 A resource provides benefits to an entity in the form of service potential or the ability to generate economic benefits. In reaching its conclusions on the nature of a resource the IPSASB considered whether the benefits of the resource must have already flowed to an entity in order for a resource to exist. However, the IPSASB concluded that resources themselves embody benefits—benefits that can be accessed by the entity that controls the rights to these benefits. The IPSASB also considered the nature of the benefits (see paragraphs BC5.7 and BC5.8) and control (see paragraphs BC5.9-BC5.14).

Unconditional Rights and Executory Contracts

BC5.4 Unconditional rights to resources typically result from contracts or other binding arrangements that require provision of resources to the entity in the future. The IPSASB notes that there can be a large number of such rights and acknowledged that unconditional rights that represent service potential or the ability to generate economic benefits that are controlled by the entity as a result of a past event give rise to assets. Whether such assets are recognized depends on whether the recognition criteria have been satisfied. The IPSASB concluded that the consequences of application of the definition of an asset to unconditional rights should be addressed at standards level.

BC5.5 Executory contracts are binding arrangements where there is an unconditional right to receive resources and an equal present obligation to transfer resources to the counterparty in the future. Public sector entities are likely to engage in a large number of such arrangements. The IPSASB acknowledges the view that such arrangements may give rise to both assets and liabilities, as there is a right to receive resources and a present obligation to sacrifice resources, which the entity has no realistic alternative to avoid.

BC5.6 The IPSASB also acknowledges the view that recognizing assets and liabilities from executory contracts would involve the inclusion of potentially very large amounts of assets and liabilities in the statement of financial position and the statement of financial performance and that this may conflict with the qualitative characteristic of understandability. Whether assets and liabilities arise from rights and obligations in executory contracts will be determined by an assessment of whether those rights and obligations satisfy the definitions of elements and recognition criteria identified in the Conceptual Framework. Such assessments, and the approach to presentation in the financial statements of any elements arising from executory contracts, are considered at standards level.

Service Potential and Economic Benefits

BC5.7 The term “service potential” has been used to identify the capacity of an asset to provide services in accordance with an entity’s objectives. The term “economic benefits” has been used to reflect the ability of an asset to generate net cash inflows. Some argue that economic benefits includes service potential. Others argue that service potential includes economic benefits—a further view is that the terms can be used interchangeably. The IPSASB considered whether the explanation of a resource should include a reference to both service potential and the ability to generate economic benefits.

BC5.8 The IPSASB noted that many respondents to the Consultation Paper and Exposure Draft supported inclusion of a specific reference to service potential as a characteristic of an asset, because of the service delivery objectives of most public sector entities. The IPSASB therefore concluded that the explanation of a resource should include both the terms “service potential” and “economic benefits”. This approach acknowledges that the primary objective of most public sector entities is to deliver services, but also that public sector entities may carry out activities with the sole objective of generating net cash inflows.

Control

BC5.9 The IPSASB considered whether control is an essential characteristic of an asset or whether other indicators should be identified as essential characteristics of an asset including:

- Legal ownership;
- The right to access, and to restrict or deny the access of external parties to, the resource;
- The means to ensure that the resources are used to achieve the entity's objectives; and
- The existence of enforceable rights to service potential or economic benefits arising from a resource.

The IPSASB acknowledges the views of those who argue that control may be difficult to apply in some cases because it requires judgment to assess whether control exists. In addition, control can be erroneously applied to a resource in its entirety and not to the individual benefits that accrue from the resource. However, notwithstanding such difficulties, the IPSASB concluded that control is an essential characteristic of an asset because the presence of control facilitates the association of an asset with a specific entity.

BC5.10 Legal ownership of a resource, such as a property or item of equipment, is one method of accessing the service potential or economic benefits of an asset. However, rights to service potential or the ability to generate economic benefits may exist without legal ownership of the underlying resource. For example, the rights to service potential or the ability to generate economic benefits through the holding and use of leased property are accessed without legal ownership of the leased asset itself. Therefore, legal ownership of the resource is not an essential characteristic of an asset. Legal ownership is, however, an indicator of control.

BC5.11 The right to access a resource may give an entity the ability to determine whether to:

- Directly use the resource's service potential to provide services to beneficiaries;
- Exchange the resource for another asset, such as cash; or
- Use the asset in any of the other ways that may provide services or generate economic benefits.

BC5.12 While access to a resource is crucial, there are resources to which an entity has access which do not give rise to assets, such as air. Therefore, the ability to access a resource must be supplemented by the ability to deny or restrict the access of others to that resource—for example, (a) an entity might decide whether to set an entrance fee to a museum and restrict access to those who do not pay the fee, and (b) government may control a natural resource under its land to which it can restrict the access of others. Legally enforceable claims to specific resources, such as a right of access to a road or a right to explore land for mineral deposits, could represent an asset to the holder. However, an entity may be able to access the service potential or ability to generate economic benefits associated with a resource in ways that do not require legal rights. The IPSASB took the view that the factors identified in paragraph BC5.9 are likely to be indicators of the existence of control rather than essential characteristics of the definition of an asset.

BC5.13 The IPSASB also considered whether the economic ownership approach is a viable alternative to the control approach. The economic ownership approach focuses on an entity's exposure to the underlying economic attributes that contribute to an asset's value to the entity. Some respondents to the Exposure Draft, *Elements and Recognition in Financial Statements*, in supporting the control approach, commented on the complexity of the economic ownership approach. The IPSASB concluded that the economic ownership approach is subjective and difficult to operate, and therefore rejected this approach.

BC5.14 The IPSASB considered whether an analysis of exposure to the risks and rewards of ownership is a useful indicator of control. The control approach focuses on the power of the entity to direct how the resource is used in order to benefit from the service potential and/or ability to generate economic benefits embodied in the resource. The risks and rewards approach focuses on an entity's exposure to the underlying economic attributes that contribute to an asset's value to the entity and the related risks. Consideration of the risks and rewards associated with particular transactions and events, and which party to any transaction or event bears the majority of those risks and rewards, may be relevant and useful in identifying the nature of the asset controlled by parties to the transaction or event. It may also be useful in determining how to quantify and associate the economic rights and obligations with particular parties. However, it is not of itself an indicator of the party that controls an asset. The IPSASB therefore decided not to include the risks and rewards of ownership as an indicator of control.

Past Event

BC5.15 Some respondents to the Consultation Paper and Exposure Draft argued that identification of a past transaction or other event which gives rise to the asset should be an essential characteristic of the definition of an asset. Others take the view that the identification of a past event is not necessary and should not therefore be an essential characteristic. They consider that such a requirement places undue emphasis on identifying the past event that gave rise to an asset. Such emphasis may be a distraction and lead to debates about which event is the triggering event instead of the more important issue of whether rights to resources exist at the reporting date. Those who take this view consider that the essential characteristic of an asset should be the existence of a resource. Some may accept that a past event provides useful supporting evidence of the existence of an asset, but not that it should be an essential characteristic.

BC5.16 Many respondents took the view that a past event should be identified as an essential characteristic of the definition of an asset. The IPSASB agrees with these respondents—in particular, that the complex nature of many public sector programs and activities means that there are a number of points at which control of a resource might arise. Therefore, the IPSASB concluded that identification of the appropriate past event is crucial in identifying whether an asset exists.

BC5.17 The powers and rights of government are particularly significant for the identification of assets. The power to tax and issue licenses, and other powers to access or to deny or restrict access to the benefits embodied in intangible resources like the electromagnetic spectrum, are examples of sovereign powers. It is often difficult to determine when such powers give rise to a right that is a resource and asset of the entity.

BC5.18 A government's power to establish a right to levy a tax or fee, for example, often begins a sequence of events that ultimately results in the flow of economic benefits to the government. The IPSASB considered two views of when an asset arises from the powers and rights of government to levy a tax or fee. The first view is that the government has an inherent power to tax at every reporting date and, therefore, that the general ability to levy taxes or fees is an asset. Proponents of this view accept that such an asset is unlikely to be capable of faithfully representative measurement, but argue that this should not deflect from an acknowledgement that government has a perpetual asset. The contrary view is that the power to levy taxes and fees must be converted into a right by legal means, and that such a right must be exercised or exercisable in order for an asset to come into existence. Many respondents to the Consultation Paper and Exposure Draft supported this latter view. The IPSASB agrees with these respondents. In particular, the IPSASB concluded that a government's inherent powers do not give rise to assets until these powers are exercised and the rights exist to receive service potential or economic benefits.

Liabilities

A Present Obligation

BC5.19 In considering when obligations are present obligations, the IPSASB accepts that a legal obligation gives rise to a present obligation. In some jurisdictions, public sector entities are not permitted to enter into certain legal arrangements, but there are equivalent mechanisms that give rise to a present obligation. Such mechanisms are considered legally binding. The IPSASB then considered how to classify obligations that are not legal obligations. The

IPSASB noted that "constructive obligation" is a term embedded in standard-setting literature globally and has been used in IPSASs. However, it has proved difficult to interpret and apply in a public sector context. Therefore, the IPSASB considered alternative terminology, for example the term "a social or moral duty or requirement." The IPSASB has concerns that the term "social" might be confused with political values and that the term "moral obligations" risks a perception that standard setters and preparers are arbiters of morality. Therefore, the IPSASB decided that making a distinction between "legally binding" and "non-legally binding obligations" is the most straightforward and understandable approach. The IPSASB considered and rejected the view that the term "non-legally binding obligations" might be interpreted as referring to obligations, the legality of which is questionable. Paragraphs BC5.30-BC5.34 discuss non- legally binding obligations and explain their meaning for the purposes of the Conceptual Framework.

BC5.20 In the context of a present obligation, the IPSASB considered whether "conditional" and "unconditional" obligations, "stand-ready obligations" and "performance obligations" might be present obligations.

Conditional and Unconditional Obligations

BC5.21 An unconditional obligation is one that stands on its own, independent of future events. Unconditional obligations give rise to liabilities if the definition of a liability is satisfied. A conditional obligation involves the possible occurrence of a future event, which may or may not be under the control of the reporting entity. The IPSASB concluded that it is possible for conditional obligations to give rise to liabilities as defined in the Conceptual Framework. Determining whether a conditional obligation satisfies the definition of a liability will involve consideration of the nature of the obligation and the circumstances in which it has arisen. Given the complexity of public sector programs and activities, identifying the past event (or events), which has (have) resulted in the entity having little or no realistic alternative to avoid an outflow of resources, often may not be straightforward. Guidance on whether conditional obligations that exist in particular arrangements or circumstances may give rise to liabilities consistent with the definitions identified in the Conceptual Framework is a standards-level issue.

BC5.22 A variety of terms are used to describe present obligations that may arise from, or exist in conjunction with, conditional obligations in particular circumstances. Amongst these are stand ready-obligations and performance obligations. The characteristics of these obligations and the conclusions reached by the IPSASB in the context of the Conceptual Framework are outlined below.

Stand-Ready Obligations

BC5.23 Stand-ready obligations are a type of conditional obligation. Stand-ready obligations require an entity to be prepared to fulfill an obligation if a specified uncertain future event outside the entity's control occurs (or fails to occur). The term stand-ready obligation is used to describe a liability that may arise in certain contractual circumstances, such as those related to insurance, certain financial instruments such as a derivative contract in a loss position, and for warranties where the entity has an obligation to transfer resources if a specified future event occurs (or does not occur). In such circumstances, there may be an identifiable past event and an outflow of resources from the entity, although the exact identity of the party to whom settlement will be made will not generally be known.

BC5.24 The Consultation Paper included a discussion of stand-ready obligations. Many respondents found the distinction between a stand-ready obligation and other conditional obligations ambiguous**.** The Exposure Draft explained that the term stand-ready obligation is not widely used in the public sector, and does not work well in certain public sector circumstances, and suggested that whether a stand-ready obligation gave rise to a liability is a standards-level issue. Some respondents did not agree with the explanation in the Exposure Draft, and expressed a view that the Conceptual Framework should provide guidance for use at the standards level on whether stand-ready obligations can give rise to liabilities in certain circumstances.

BC5.25 A public sector entity's obligation to transfer resources to another entity in particular circumstances that may occur in the future includes, for example, as a potential lender of last resort and in support of programs that provide a wide range of social benefits. The existence of an obligation to transfer resources to another party in these circumstances may be dependent on ongoing satisfaction of a number of conditions of differing significance and nature that are subject to change by the government or public sector entity. The IPSASB is of the view that the circumstances in which liabilities arise as a consequence of the obligation of a public sector entity to transfer resources to other parties consistent with the terms of programs, and how such liabilities should be described and accounted for, should be considered at the standards level consistent with the principles established in the Conceptual Framework. The IPSASB decided that the Conceptual Framework should not resolve whether all obligations that might be classified as stand-ready meet the definition of a liability. The IPSASB also decided not to use the term "stand-ready obligation" in the Conceptual Framework.

Performance Obligations

BC5.26 A performance obligation is an obligation in a contract or other binding arrangement between an entity and an external party to transfer a resource to that other party. Performance obligations are often explicitly stated in a contract or other arrangement. Not all performance obligations are explicit. For example, a statutory requirement may give rise to an implicit performance obligation of a public sector entity that is additional to the terms of an agreement or contract.

BC5.27 A performance obligation also arises when an entity enters into an arrangement whereby it receives a fee and, in return, provides an external party with access to an asset of the government. The IPSASB concluded that it is not necessary to identify a specific external party for a performance obligation to arise, but it is important to analyze such obligations in order to determine whether they include a requirement to provide an outflow of resources. Obligations that require an entity to provide access to a resource, but do not entail an outflow of resources do not give rise to liabilities. However, obligations that require an entity to forgo future resources may be liabilities. Performance obligations are often conditional obligations. Determining whether such obligations give rise to liabilities is dependent upon the terms of particular binding agreements and may vary between jurisdictions. The IPSASB concluded that the circumstances under which performance obligations give rise to liabilities should be considered at standards level.

Past Event

BC5.28 The IPSASB considered whether the definition of a liability should require the existence of a past transaction or other event. Some take the view that identification of a past event is not an essential characteristic of a liability, and that, consequently, there is no need for the definition of a liability to include a reference to a past event. These commentators argue that there may be many possible past events and that establishing the key past event is likely to be arbitrary. They suggest that the identification of a past event is not a primary factor in determining whether a liability exists at the reporting date. This view mirrors the opposition to the inclusion of a past event in the definition of an asset, which is discussed in paragraphs BC5.15-BC5.18.

BC5.29 The IPSASB acknowledges this view, but also noted that many respondents to the Consultation Paper and Exposure Draft consider that a past event is a characteristic of a liability. The IPSASB agrees with the view that the complexity of many public sector programs and activities and the number of potential points at which a present obligation might arise means that, although challenging, identification of the past event that gives rise to a liability is critical in determining when public sector liabilities should be recognized.

Little or No Realistic Alternative to Avoid

BC5.30 Some respondents to the Exposure Draft expressed concerns that the phrase "little or no realistic alternative to avoid" in the description of a present obligation is open to different interpretations. They proposed removal of the words "little or" from this phrase in order to reduce the potential for misinterpretation. The IPSASB considered this proposal. The IPSASB was concerned that such a change might be interpreted as establishing a threshold test of virtual certainty in determining whether a present obligation exists. The IPSASB considers such a threshold too high. Consequently, the IPSASB confirmed that a present obligation is a legally binding or non-legally binding requirement that an entity has little or no realistic alternative to avoid.

BC5.31 Determining when a present obligation arises in a public sector context is complex and, in some cases, might be considered arbitrary. This is particularly so when considering whether liabilities can arise from obligations that are not enforceable by legal or equivalent means. In the context of programs to deliver social benefits there are a number of stages at which a present obligation can arise and there can be significant differences between jurisdictions, even where programs are similar, and also over time within the same jurisdiction —for example, different age cohorts may have different expectations about the likelihood of receiving benefits under a social assistance program. Assessing whether a government cannot ignore such expectations and therefore has little or no realistic alternative to transfer resources may be subjective. This gives rise to concerns that such subjectivity undermines consistency in the reporting of liabilities, and can also impact adversely on understandability. Some therefore take the view that an essential characteristic of a liability should be that it is enforceable at the reporting date by legal or equivalent means.

BC5.32 A converse view is that where a government has a record of honoring obligations, failing to recognize them as liabilities leads to an overstatement of that government's net financial position. According to this view, if a government has a consistent record of raising citizen expectations through publicly-announced obligations to provide financial support—for example to the victims of natural disasters—and has met such obligations in the past, a failure to treat such obligations as liabilities is not in accordance with the objectives of financial reporting, and leads to the provision of information that does not meet the qualitative characteristics of faithful representation and relevance.

BC5.33 On balance, the IPSASB agrees with those who argue that, in the public sector, liabilities can arise from binding obligations that the entity has little or no realistic alternative to avoid, even if they are not enforceable in law. The IPSASB decided to use the term "non-legally binding obligations" for such obligations in the Conceptual Framework. However, the IPSASB acknowledges the views of those who are skeptical that liabilities can arise from obligations that are not legally enforceable. Consequently, paragraph 5.23 of this Chapter identifies the attributes that a non-legally binding obligation is to possess for it to give rise to a liability.

BC5.34 The wide variation in the nature of public sector programs and operations, and the different political and economic circumstances of jurisdictions globally, means that categorical assertions of the circumstances under which obligations not enforceable in law become binding and give rise to present obligations are inappropriate. However, the IPSASB is of the view that present obligations are extremely unlikely to arise from election pledges. This is because electoral pledges will very rarely, (a) create a valid expectation on the part of external parties that the entity will honor the pledge, and (b) create an obligation which the entity has no realistic alternative but to settle. Therefore the Framework includes a presumption that liabilities do not arise from electoral pledges. However, it is accepted that in practice a government with a large majority will be better placed to enact intended legislation than a minority government, and that there may be infrequent circumstances where a government announcement in such circumstances might give rise to a liability. In assessing whether, in these circumstances, a non-legally binding obligation gives rise to a liability the availability of funding to settle the obligation may be an indicator. This is discussed in paragraph 5.25.

Sovereign Power to Avoid Obligations

BC5.35 The sovereign power to make, amend and repeal legal provisions is a key characteristic of governments. Sovereign power potentially allows governments to repudiate obligations arising from both exchange and non-exchange transactions. Although in a global environment such a power may be constrained by practical considerations, there are a large number of examples of governments defaulting on financial obligations over the last century. The IPSASB considered the impact of sovereign power on the definition of a liability. The IPSASB concluded that failing to recognize obligations that otherwise meet the definition of a liability on the grounds that sovereign power enables a government to walk away from such obligations would be contrary to the objectives of financial reporting and, in particular, may conflict with the qualitative characteristics of relevance and faithful representation. Many respondents to the Consultation Paper and the Exposure Draft supported this position. The IPSASB therefore concluded that the determination of the existence of a liability should be by reference to the legal position at the reporting date.

Commitments

BC5.36 Commitment accounting procedures are a central component of budgetary control for public sector entities in many jurisdictions. They are intended to assure that budgetary funds are available to meet the government’s or other public sector entity’s responsibility for a possible future liability, including intended or outstanding purchase orders and contracts, or where the conditions for future transfers of funds have not yet been satisfied. Commitments which satisfy the definition of a liability and the recognition criteria are recognized in financial statements, in other cases information about them may be communicated in notes to the financial statements or other reports included in GPFRs. The IPSASB concluded that commitment accounting might be addressed in the future when dealing with elements for the more comprehensive areas of general purpose financial reporting outside the financial statements.

Net Financial Position, Other Resources and Other Obligations

BC5.37 This section of the Basis for Conclusions outlines the IPSASB's approach to models of financial performance to be reported in the financial statements, and specifically the treatment of deferred inflows and deferred outflows.

Consultation Paper, Elements and Recognition in Financial Statements

BC5.38 The Consultation Paper discussed two contrasting approaches to financial performance:

- An approach that measures financial performance as the net result of all changes in the entity's resources and obligations during the period. This was described as the asset and liability-led approach; and
- An approach that measures financial performance as the result of the revenue inflows and expense outflows more closely associated with the operations of the current period. This was described as the revenue and expense-led approach.

BC5.39 The Consultation Paper noted that the two different approaches could lead to different definitions of the elements related to financial performance and financial position. The revenue and expense-led approach is strongly linked to the notion of inter-period equity. Inter-period equity refers to the extent to which the cost of programs and providing services in the reporting period is borne by current taxpayers and current resource providers. The asset and liability-led approach is linked to the notion of changes in resources available to provide services in the future and claims on these resources as a result of period activity.

BC5.40 A further section of the Consultation Paper discussed Other Potential Elements and pointed out that, if IPSASB adopted the revenue and expense-led approach, IPSASB would need to address deferred flows. Under this approach, deferred flows are items that do not meet the proposed definitions of revenue and expense, but which are nevertheless considered to affect the financial performance of the period. The Consultation Paper identified three options for dealing with such flows:

- Defining deferred inflows and deferred outflow as elements on the statement of financial position;

- Broadening the asset and liability definitions to include items that are deferrals; or
- Describing deferred flows as sub-classifications of net assets/net liabilities (subsequently referred to as the residual amount).

BC5.41 The Consultation Paper had two specific matters for comment on these areas. The first asked constituents to indicate whether they preferred the asset and liability-led approach or revenue and expense-led approach and to indicate their reasons. The second asked whether deferred inflows and deferred outflows need to be identified on the statement of financial position. If respondents supported identification on the statement of financial position they were asked to indicate which of the three approaches in paragraph BC5.40 they supported.

BC5.42 The responses to these specific matters for comment were inconclusive. A small majority of respondents expressing a view favored the asset and liability-led approach. However, a number of respondents who supported the asset and liability-led approach also indicated that they favored identifying deferrals on the statement of financial position. The IPSASB took these views into account at Exposure Draft stage.

Exposure Draft, Elements and Recognition in Financial Statements

BC5.43 The Exposure Draft expressed a view that it is important to be able to distinguish flows that relate to the current reporting period from those that relate to specified future reporting periods. The Exposure Draft therefore proposed the following definitions of a deferred inflow and a deferred outflow:

- *A deferred inflow is an inflow of service potential or economic benefits provided to the entity for use in a specified future reporting period that results from a non-exchange transaction and increases net assets; and*
- *A deferred outflow is an outflow of service potential or economic benefits provided to another entity or party for use in a specified future reporting period that results from a non-exchange transaction and decreases net assets.*

BC5.44 The two key features of these definitions were:

- The proposed elements were restricted to non-exchange transactions; and
- The flows had to be related to a specified future period.

BC5.45 The IPSASB's rationale for including these characteristics were as risk-avoidance measures to reduce the possibility of deferred inflows and deferred outflows being used widely as smoothing devices, and to ensure that deferred inflows and deferred outflows are not presented on the statement of financial position indefinitely. The Exposure Draft included two Alternative Views. The first Alternative View considered the meaning of net financial position to be unclear in light of the combined impact of deferred inflows and deferred outflows. The second Alternative View disagreed with the view that deferred inflows and deferred outflows should be identified and recognized as separate elements and expressed a view that these flows meet the definitions of revenue and expense.

BC5.46 Many respondents disagreed with defining deferred inflows and deferred outflows as elements. Some expressed reservations about the implications for alignment with the International Accounting Standards Board's Conceptual Framework, and International Financial Reporting Standards more generally. A number of respondents considered that the proposed approach did not reflect economic reality and that it would be more difficult to determine an objective basis for deferring revenue and expense under the revenue and expense-led approach. Nevertheless, a number of respondents also expressed the view that information on flows relating to particular reporting periods has information value.

BC5.47 The rationale for restricting the definitions to non-exchange transactions was challenged as conceptually weak both by respondents who favored defining deferred inflows and deferred outflows as elements and those opposed to these proposed elements. Respondents also disagreed with the restriction to specified time periods, because it would potentially lead to the different accounting treatment of very similar transactions dependent upon whether a specific period was identified—a grant without conditions receivable by an entity to finance its general activities for a five year period would have met the definition of a deferred inflow, whereas a similar grant for a future unspecified period would have met the definition of revenue.

Finalizing the Elements Chapter

BC5.48 The IPSASB considered that it needed to balance the limited support for the proposals on deferred flows in the Exposure Draft, and the perceived needs of users for information about flows relating to particular reporting periods.

BC5.49 The IPSASB therefore considered five options (A–E below) in responding to input from the due process and its perception of users' information needs:

A. Defining deferred inflows and deferred outflows as elements in a more principles-based manner and not specifying the financial statements in which the elements are to be recognized. As such, the Conceptual Framework would not predetermine the presentation of the elements;

B. Deriving the definitions of revenue and expense from the asset and liability definitions;

C. Broadening the asset and liability definitions;

D. Accepting that certain economic phenomena that do not meet the definition of any element may need to be recognized in financial statements in order to meet the objectives of financial reporting; and

E. Reporting inflows and outflows that provide service potential or economic benefits, but do not affect assets and liabilities as defined in the Framework and reporting inflows and outflows that do not affect revenue and expense.

BC5.50 The IPSASB does not consider that defining deferred inflows and deferred outflows as elements in Option A is justified in light of the objections that respondents had made to the proposals in the Exposure Draft. The IPSASB therefore rejected Option A.

BC5.51 The IPSASB considered two variants of Option B. In the first variant deferred flows would be taken directly to surplus/deficit, while in the second variant deferred flows would initially be taken to residual amount and then recycled to surplus/deficit in the period that time stipulations occur.

BC5.52 The IPSASB considers that taking deferred flows directly to surplus/deficit under the first variant of Option B may not produce information that is representationally faithful of an entity's sustainable performance and therefore does not meet the objectives of financial reporting. The second variant of Option B relies on recycling and, in the view of some IPSASB members would have implicitly introduced the notion of "other comprehensive income" into the Framework. The IPSASB has strong reservations about such a development. For these reasons the IPSASB rejected Option B.

BC5.53 The IPSASB noted that Option C would require changes to the definitions of an asset and a liability so that:

- The definition of an asset would include resources that an entity does not control; and
- The definition of a liability would include obligations that are not present obligations.

The IPSASB considers that such changes would distort the essential characteristic of an asset—that an entity controls rights to resources—and the essential characteristic of a liability—that an entity has a present obligation for an outflow of resources. In the view of the IPSASB this would make assets and liabilities less easily understandable. Adoption of such an option would also be a departure from globally understood definitions of an asset and a liability. For these reasons the IPSASB rejected Option C.

BC5.54 Option E was a hybrid approach that involved components of the other four options. It would allow reporting of inflows and outflows that provide service potential or economic benefits, but would not affect the definitions of an asset and liability and the reporting of inflows and outflows that do not affect revenue and expense as defined in the Framework. The idea of this approach was to acknowledge that further conceptual thinking on financial performance is necessary.

BC5.55 Option D is broader than Option E because it is not necessarily restricted to deferred flows, but could encompass broader economic phenomena—for example obligations that are not present obligations, because, although they contain performance obligations, it is not clear that they require an outflow of resources. Option D acknowledges that there may be circumstances under which the six elements defined in the Conceptual Framework may not provide all the information in the financial statements that is necessary to meet users' needs. In the view of the IPSASB it is transparent to acknowledge that other items may be recognized. Unlike Option A, Option D does not involve defining additional elements, and, unlike Option C, Option D does not involve modification of generally understood definitions of an asset and a liability.

BC5.56 The IPSASB concluded that Option D provides the most transparent approach. The terms "other obligations" and "other resources" are used to describe these economic phenomena in the Conceptual Framework. Option D also enhances the accountability of the IPSASB because the circumstances under which other obligations and other resources will be recognized will be determined at standards level and explained in the Bases for Conclusions of specific standards.

Financial Statements

BC5.57 Net financial position is the aggregate of an entity's net assets (assets minus liabilities) and other resources and other obligations recognized in the statement of financial position at the reporting date. Where resources and obligations other than those that meet the definition of the elements are recognized in the financial statements, the amounts reported as net assets and net financial position will differ. In these circumstances, the interpretation of net financial position will be determined by reference to the nature of the other resources and other obligations recognized in the financial statements under the relevant IPSAS.

BC5.58 The IPSASB considered whether it should use both the terms "net assets" and "net financial position" in the Conceptual Framework. The IPSASB acknowledges a view that net assets is a generally understood term. However, the IPSASB considered that using both terms could be confusing and therefore decided to use the term "net financial position" to indicate the residual amount of an entity.

Revenue and Expense

Gross or Net Increase in "Net Financial Position" in Definition of Revenue

BC5.59 The IPSASB considered whether the definition of revenue should specify that the increase in net financial position is "gross" or "net". The IPSASB acknowledges that a gross approach might not be appropriate in areas such as the disposal of property, plant, and equipment where such an approach would require the full disposal proceeds to be recognized as revenue, rather than the difference between the disposal proceeds and the carrying amount. Conversely, a net approach might be similarly inappropriate in certain circumstances—for example, the sale of inventory. The IPSASB concluded that whether the increase in net financial position represented by revenue is presented gross or net should be determined at standards level, dependent on which treatment better meets the objectives of financial reporting.

Distinguishing Ordinary Activities from Activities outside the Ordinary Course of Operations

BC5.60 Some standard setters structure their definitions of elements so that, for example, inflows and outflows arising from transactions and events relating to activities in the ordinary course of operations are distinguished from inflows and outflows that relate to activities outside the ordinary course of operations. An example of this approach is to define revenue and expense as elements that relate to an entity's "ongoing major or central operations", and to define gains and losses as elements that relate to all other transactions, events and circumstances giving rise to increases or decreases in net assets.[7]

BC5.61 The IPSASB acknowledges that distinguishing transactions and events related to the ordinary course of operations from transactions and events outside the ordinary course of operations can provide useful information for users of the financial statements. Therefore, it may be useful to adopt the terms "gains and losses" to reflect inflows and outflows from transactions and events outside the ordinary course of operations. However, the IPSASB is of the view that, conceptually, gains and losses do not differ from other forms of revenue and expense, because they both involve net increases or decreases of assets and/or liabilities. The IPSASB also noted that many respondents to the Consultation Paper and Exposure Draft shared this view. Therefore the IPSASB decided not to define gains and losses as separate elements.

Ownership Interests in the Public Sector

BC5.62 As discussed in more detail in BC5.66-BC5.70, the IPSASB considered whether, and, if so, under what circumstances, ownership interests exist in

[7] See, for example, Financial Accounting Standards Board, Statement of Financial Accounting Concepts No. 6, *Elements of Financial Statements*.

the public sector and whether transactions related to ownership interests should be excluded from the definitions of revenue and expense. Because transactions with owners, in their role as owners, are different in substance to other inflows and outflows of resources the IPSASB concluded that it is necessary to distinguish flows relating to owners from revenue and expense. Therefore ownership contributions and ownership distributions are defined as elements and excluded from the definitions of revenue and expense.

Surplus or Deficit in the Reporting Period

BC5.63 This chapter states that the difference between revenue and expense is the entity's surplus or deficit for the period. The IPSASB considered whether it should provide explanatory guidance on the interpretation of surplus or deficit. The IPSASB discussed a view that public sector entities have operating and funding models. According to this view a surplus provides an indicator of the ability of the entity to:

- Reduce demands for resources from resource providers;
- Increase either the volume and/or quality of services to recipients;
- Reduce debt (where an entity has debt-raising powers); or
- A combination of these factors.

BC5.64 Conversely a deficit provides an indicator of:

- The need to increase demands on resources from resource providers;
- Reduce either the volume and/or quality of services to recipients;
- Increase debt (where an entity has debt-raising powers); or
- A combination of these factors.

BC5.65 The IPSASB acknowledges that there is a need for greater clarity on the meaning of surplus or deficit in the public sector, and therefore that aspects of the above approach might be developed further in the future. However, the IPSASB considered the concept of an operating and funding model or business model is not well developed in the public sector, and that developing an operating and funding model appropriate for all public sector entities is problematic. Therefore, the IPSASB decided not to include guidance on the interpretation of surplus or deficit in the Conceptual Framework.

Ownership Contributions, and Ownership Distributions

BC5.66 The IPSASB considered whether net financial position is a residual amount, a residual interest or an ownership interest. The IPSASB acknowledges the view that the interest of resource providers and service recipients in the long-term efficiency of the entity, its capacity to deliver services in the future and in the resources that may be available for redirection, restructuring or alternative disposition is similar to an ownership interest. The IPSASB also accepts that the terms "residual interest" and "ownership interest" have been used in some jurisdictions to characterize third parties' interests in net assets. The term "residual interest" indicates that service recipients and resource providers have an interest in the capability of the entity to finance itself and to resource future operations. The term "ownership interest" is analogous to the ownership interest in a private sector entity and, for some, indicates that the citizens own the resources of the public sector entity and that government is responsible to the citizens for the use of those resources. Some supporters of this approach argue that it emphasizes the democratic accountability of governments.

BC5.67 The IPSASB is of the view that the term "residual interest" may also suggest that service recipients and resource providers have a financial interest in the public sector entity. Similarly the term "ownership interest" may suggest that citizens are entitled to distributions from the public sector entity and to distributions of resources in the event of the entity being wound up. The IPSASB therefore concluded that the terms "residual interest" and "ownership interest" can be misunderstood or misinterpreted, and that net financial position is a residual amount that should not be defined.

BC5.68 However, the IPSASB acknowledges that part of net financial position can in certain circumstances be an ownership interest. Such instances may be evidenced by the entity having a formal equity structure. However, there may be instances where an entity is established without a formal equity structure, with a view to sale for operation as a commercial enterprise or by a private sector not-for-profit entity. An ownership interest can also arise from the restructuring of government or public sector entities, such as when a new government department is created. The IPSASB therefore considered whether ownership interests should be defined as an element. The IPSASB acknowledges the view that identifying the resources (or claims on future resources) attributable to owners provides information useful for accountability and decision-making purposes. The IPSASB concluded that such interests can be identified through the sub-classification of net financial position. However, the IPSASB also concluded that it is important to distinguish inflows of resources from owners and outflows of resources to owners, in their role as owners, from revenue, expense, other resources and other obligations. Therefore, ownership contributions and ownership distributions are defined as elements. Detailed guidance to support the assessment of whether certain inflows and outflows of resources satisfy the definitions of ownership contributions and ownership distributions will be developed at standards level, as appropriate.

CHAPTER 6: RECOGNITION IN FINANCIAL STATEMENTS

CONTENTS

Recognition Criteria and their Relationship to Disclosure

6.1 This chapter identifies the criteria that must be satisfied in order for an element to be recognized in the financial statements. Recognition is the process of incorporating and including in amounts displayed on the face of the appropriate financial statement an item that meets the definition of an element and can be measured in a way that achieves the qualitative characteristics and takes account of the constraints on information included in GPFRs.

6.2 The recognition criteria are that:

- An item satisfies the definition of an element; and
- Can be measured in a way that achieves the qualitative characteristics and takes account of constraints on information in GPFRs.

6.3 All items that satisfy the recognition criteria are recognized in the financial statements. In some circumstances, an IPSAS may also specify that, to achieve the objectives of financial reporting, a resource or obligation that does not meet the definition of an element is to be recognized in the financial statements provided it can be measured in a way that meets the qualitative characteristics and constraints. Other resources and other obligations are discussed in Chapter 5, *Elements in Financial Statements.*

6.4 Recognition involves an assessment of uncertainty related to the existence and measurement of the element. The conditions that give rise to uncertainty, if any, can change. Therefore, it is important that uncertainty is assessed at each reporting date.

Definition of an Element

6.5 In order to be recognized as an element an item must meet the definition of one of the elements in Chapter 5. Uncertainty about the existence of an element is addressed by considering the available evidence in order to make a neutral judgment about whether an item satisfies all essential characteristics of the definition of that element, taking into account all available facts and circumstances at the reporting date.

6.6 If it is determined that an element exists, uncertainty about the amount of service potential or ability to generate economic benefits represented by that element is taken into account in the measurement of that element (see paragraphs 6.7 and 6.8). Preparers review and assess all available evidence in determining whether an element exists and is recognized, whether that element continues to qualify for recognition (see paragraph 6.9), or whether there has been a change to an existing element.

Measurement Uncertainty

6.7 In order to recognize an item in the financial statements, it is necessary to attach a monetary value to the item. This entails choosing an appropriate measurement basis and determining whether the measurement of the item achieves the qualitative characteristics, taking into account the constraints on information in GPFRs, including that the measurement is sufficiently relevant and faithfully representative for the item to be recognized in the financial statements. The selection of an appropriate measurement basis is considered in Chapter 7, *Measurement of Assets and Liabilities in Financial Statements.*

6.8 There may be uncertainty associated with the measurement of many amounts presented in the financial statements. The use of estimates is an essential part of the accrual basis of accounting. A decision about the relevance and faithful representativeness of measurement involves the consideration of techniques, such as using ranges of outcomes and point estimates, and whether additional evidence is available about economic circumstances that existed at the reporting date. Disclosures can provide useful information on estimation techniques employed. There may be rare instances in which the level of uncertainty in a single point estimate is so large that the relevance and faithful representativeness of the measure is questionable even if disclosures are provided to explain estimation techniques. Under these circumstances the item is not recognized.

Disclosure and Recognition

6.9 The failure to recognize items that meet the definition of an element and the recognition criteria is not rectified by the disclosure of accounting policies, notes or other explanatory detail. However, disclosure can provide information about items that meet many, but not all the characteristics of the definition of an element. Disclosure can also provide information on items that meet the definition of an element but cannot be measured in a manner that achieves the qualitative characteristics sufficiently to meet the objectives of financial reporting. Disclosure is appropriate when knowledge of the item is considered to be relevant to the evaluation of the net financial position of the entity and therefore meets the objectives of financial reporting.

Derecognition

6.10 Derecognition is the process of evaluating whether changes have occurred since the previous reporting date that warrant removing an element that has been previously recognized from the financial statements, and removing the item if such changes have occurred. In evaluating uncertainty about the existence of an element the same criteria are used for derecognition as at initial recognition.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Recognition and its Relationship to the Definition of the Elements

BC6.1 The IPSASB considered whether recognition criteria should be integrated in definitions of the elements. The IPSASB acknowledges the view that the inclusion of recognition criteria in definitions of the elements enables preparers to consider all the factors that must be taken into account in evaluating whether an item of information is recognized as an element in the financial statements. However, the IPSASB is of the view that while there is overlap in factors to be considered in determining whether an item satisfies the definition of an element and whether that element qualifies for recognition, recognition should be considered as a distinct stage in the financial reporting process. This is because recognition is broader than whether the definition of an element is satisfied. The IPSASB also noted that few respondents to the Consultation Paper and Exposure Draft supported the integration of recognition criteria in element definitions. After considering the input from the due process, the IPSASB concluded that the definitions of elements should not include recognition criteria.

BC6.2 In determining whether an element should be recognized there are two types of uncertainty that need to be considered. The first is uncertainty about whether the definition of an element has been satisfied. The second is measurement uncertainty—whether the element can be measured in a manner that achieves the qualitative characteristics. Measurement uncertainty is considered if it is determined that the definition of an element has been met. While recognition is viewed as a distinct stage in the accounting process, matters relevant to an assessment of uncertainty over the existence of an element will have been considered in determining whether the item satisfies the definition of an element.

Satisfying the Definition of an Element

BC6.3 The IPSASB considered whether, in dealing with uncertainty over the existence of an element, standardized probability threshold criteria should be adopted, or whether all available evidence should be used to make neutral judgements about an element’s existence.

BC6.4 Standardized evidence thresholds filter out items that have a low probability of resulting in an inflow or outflow of service potential or the ability to generate economic benefits. Such items may have high monetary values, even though the probability of existence may be low. Some consider that it is more appropriate to disclose such items rather than to recognize them. Threshold criteria are also justified on cost grounds, because only after a preparer has formed an initial judgement about whether those threshold criteria have been met does that preparer consider how that element should be measured.

BC6.5 The IPSASB formed a view that the adoption of thresholds for recognition purposes risks omitting information that is relevant and faithfully representative, because similar information items may be treated in different ways dependent upon relatively small differences in the probability of a flow of benefits. The IPSASB acknowledges that such risks can also exist for approaches which do not specify thresholds for recognition. This is because preparers will make their own assessments of the circumstances or "the threshold" that justifies recognition, and those assessments can change for different items and over time. However, the IPSASB concluded that, on balance, an approach that is based on an assessment of all available evidence in determining whether an element exists and takes account of uncertainty about the flows of service potential or the ability to generate economic benefits in measurement is a more appropriate response to the uncertainty faced by preparers of financial statements. It is more likely to result in the recognition of information that satisfies the qualitative characteristics than the establishment of an arbitrary threshold that must be adhered to. Guidance may be provided at standards level on dealing with circumstances in which there is significant uncertainty about whether an element exists in particular circumstances, and therefore whether it would satisfy the criteria for recognition.

BC6.6 The IPSASB explored whether uncertainty about the existence of an element is specific to certain characteristics of assets and liabilities—in particular for assets whether an entity controls rights to a resource and for liabilities whether an entity has little or no realistic alternative to avoid an outflow of service potential or economic benefits. The rationale for such a view is that these are the essential characteristics of an asset and a liability where uncertainty is likely to arise.

BC6.7 The IPSASB is of the view that, uncertainty relates to more than just these characteristics. There might also be uncertainty about the existence of a present obligation and a past event for liabilities and, for assets whether a resource that generates future economic benefits or service potential presently exists, rather than a future resource or future right to a resource. As noted in paragraph BC6.2, these matters will also have been considered in determining whether an item satisfies the definition of an element.

Derecognition

BC6.8 The IPSASB considered whether the same criteria should be used for initial recognition and derecognition. Many of the respondents to the Consultation Paper and the Exposure Draft supported the use of the same criteria for derecognition as for initial recognition. The IPSASB concluded that adopting different recognition criteria would conflict with the qualitative characteristic of consistency as it would result in the recognition of items with different standards of evidence for their existence. Therefore, the same recognition criteria should be used for initial recognition and derecognition.

CHAPTER 7: MEASUREMENT OF ASSETS AND LIABILITIES IN FINANCIAL STATEMENTS

CONTENTS

Introduction

7.1 This Chapter identifies the measurement concepts that guide the IPSASB in the selection of measurement bases for IPSASs and by preparers of financial statements in selecting measurement bases for assets and liabilities where there are no requirements in IPSASs.

The Objective of Measurement

7.2 The objective of measurement is:

To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.

7.3 The selection of a measurement basis for assets and liabilities contributes to meeting the objectives of financial reporting in the public sector by providing information that enables users to assess:

- The cost of services provided in the period in historical or current terms;
- Operational capacity—the capacity of the entity to support the provision of services in future periods through physical and other resources; and
- Financial capacity—the capacity of the entity to fund its activities.

7.4 The selection of a measurement basis also includes an evaluation of the extent to which the information provided achieves the qualitative characteristics while taking into account the constraints on information in financial reports.

Measurement Bases and their Selection

7.5 It is not possible to identify a single measurement basis that best meets the measurement objective at a Conceptual Framework level. Therefore, the Conceptual Framework does not propose a single measurement basis (or combination of bases) for all transactions, events and conditions. It provides guidance on the selection of a measurement basis for assets and liabilities in order to meet the measurement objective.

7.6 The following measurement bases for assets are identified and discussed in terms of the information they provide about the cost of services delivered by an entity, the operating capacity of an entity and the financial capacity of an entity, and the extent to which they provide information that meets the qualitative characteristics:

- Historical cost;
- Market value;
- Replacement cost;
- Net selling price; and

- Value in use.

Table 1 summarizes these measurement bases in terms of whether they (a) provide entry or exit values; (b) are observable in a market; and (c) whether or not they are entity-specific.[8]

Table 1: Summary of Measurement Bases for Assets

Measurement Basis	**Entry or Exit**	**Observable or Unobservable in a Market**	**Entity or Non-entity Specific**
Historical cost	Entry	Generally observable	Entity-specific
Market value in open, active and orderly market	Entry and exit	Observable	Non-entity-specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Replacement cost	Entry	Observable	Entity-specific
Net selling price	Exit	Observable	Entity-specific
Value in use	Exit[9]	Unobservable	Entity-specific

7.7 The following measurement bases for liabilities are identified and discussed in terms of (a) the information they provide about the cost of services delivered by an entity, the operating capacity of an entity and the financial capacity of an entity; and (b) the extent to which they provide information that meets the qualitative characteristics:

- Historical cost;
- Cost of fulfillment;
- Market value;
- Cost of release; and

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[8] In some cases a judgment has been made in classifying a particular measurement basis as observable or unobservable in a market and/or as entity or non-entity specific.

[9] As pointed out in paragraph 7.66, for non-cash-generating assets the calculation of value in use may require the use of replacement cost as surrogate.

- Assumption price.

Table 2 summarizes these measurement bases in terms of whether they (a) provide entry or exit values; (b) are observable in a market; and (c) whether or not they are entity-specific.

Table 2: Summary of Measurement Bases for Liabilities

Measurement Basis	**Entry or Exit**	**Observable or Unobservable in a Market**	**Entity or Non-entity Specific**
Historical cost	Entry	Generally observable	Entity-specific
Cost of fulfillment	Exit	Unobservable	Entity-specific
Market value in open, active and orderly market	Entry and exit	Observable	Non-entity specific
Market value in inactive market	Exit	Dependent on valuation technique	Dependent on valuation technique
Cost of release	Exit	Observable	Entity-specific
Assumption price	Entry	Observable	Entity-specific

Entry and Exit Values

7.8 Measurement bases may provide either entry or exit values. For assets, entry values reflect the cost of purchase. Historical cost and replacement cost are entry values. Exit values reflect the economic benefits from sale. An exit value also reflects the amount that will be derived from use of the asset. In a diversified economy entry and exit prices differ as entities typically:

- Acquire assets tailored to the entity's particular operating requirements for which other market participants would be unwilling to pay a similar price; and
- Incur transaction costs on acquisition.

7.9 Measurement bases for liabilities may also be classified in terms of whether they are entry or exit values. Entry values relate to the transaction under which an obligation is received or the amount that an entity would accept to assume a liability. Exit values reflect the amount required to fulfill an obligation or the amount required to release the entity from an obligation.

Observable and Unobservable Measures

7.10 Certain measures may be classified according to whether they are observable in an open, active and orderly market.[10] Measures that are observable in a market are likely to be more understandable and verifiable than measures that are not observable. They may also be more faithfully representative of the phenomena they are measuring.

Entity-Specific and Non-Entity Specific Measures

7.11 Measures may also be classified according to whether they are "entity-specific" or "non-entity- specific". Measurement bases that are entity-specific reflect the economic and current policy constraints that affect the possible uses of an asset and the settlement of a liability by an entity. Entity-specific measures may reflect economic opportunities that are not available to other entities and risks that are not experienced by other entities. Non-entity-specific measures reflect general market opportunities and risks. The decision on whether to use an entity-specific or non-entity- specific measure is taken by reference to the measurement objective and the qualitative characteristics.

Level of Aggregation or Disaggregation for Measurement

7.12 In order to present assets and liabilities in the financial statements in a way that provides information that best meets the measurement objective and achieves the qualitative characteristics it may be necessary to aggregate or disaggregate them for measurement purposes. In assessing whether such an aggregation or disaggregation is appropriate the costs are compared with the benefits.

Measurement Bases for Assets

Historical Cost

7.13 Historical cost for an asset is:

The consideration given to acquire or develop an asset, which is the cash or cash equivalents or the value of the other consideration given, at the time of its acquisition or development.

7.14 Historical cost is an entry, entity-specific value.[11] Under the historical cost model assets are initially reported at the cost incurred on their acquisition. Subsequent to initial recognition, this cost may be allocated as an expense to reporting periods in the form of depreciation or amortization for certain assets,

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10 The term "open, active and orderly markets" was developed by Dr. J. Alex Milburn. For example, see *Toward a Measurement Framework for Profit-oriented Entities*, published by the Canadian Institute of Chartered Accountants in 2012.

11 The term "historical cost" may also be referred to as the "cost model" or generically as "cost-based measures."

as the service potential or ability to generate economic benefits provided by such assets are consumed over their useful lives. Following initial recognition, the measurement of an asset is not changed to reflect changes in prices or increases in the value of the asset.

7.15 Under the historical cost model the amount of an asset may be reduced by recognizing impairments. Impairment is the extent to which the service potential or ability to generate economic benefits provided by an asset have diminished due to changes in economic or other conditions, as distinct to their consumption. This involves assessments of recoverability. Conversely, the amount of an asset may be increased to reflect the cost of additions and enhancements (excluding price increases for unimproved assets) or other events, such as the accrual of interest on a financial asset.

Costs of Services

7.16 Where historical cost is used, the cost of services reflects the amount of the resources expended to acquire or develop assets consumed in the provision of services. Historical cost generally provides a direct link to the transactions actually undertaken by the entity. Because the costs used are those carried forward from an earlier period without adjustment for price changes, they do not reflect the cost of assets when the assets are consumed. As the cost of services is reported using past prices, historical cost information will not facilitate the assessment of the future cost of providing services if cumulative price changes since acquisition are significant. Where budgets are prepared on the historical cost basis, historical cost information demonstrates the extent to which the budget has been executed.

Operational Capacity

7.17 If an asset has been acquired in an exchange transaction, historical cost provides information on the resources available to provide services in future periods, based on their acquisition cost. At the time an asset is purchased or developed, it can be assumed that the value to the entity of its service potential is at least as great as the cost of purchase.[12] When depreciation or amortization is recognized it reflects the extent to which the service potential of an asset has been consumed. Historical cost information shows that the resources available for future services are at least as great as the amount at which they are stated. Increases in the value of an asset are not reflected under the historical cost model. If an asset has been acquired in a non-exchange transaction the transaction price will not provide information on operating capacity.

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[12] Where this is not the case the initial historical cost measurement will be reduced by the amount of the impairment.

Financial Capacity

7.18 The amount at which assets are stated in financial statements assists in an assessment of financial capacity. Historical cost can provide information on the amount of assets that may be used as effective security for borrowings. An assessment of financial capacity also requires information on the amount that could be received on sale of an asset, and reinvested in assets to provide different services. Historical cost does not provide this information when significantly different from current exit values.

Application of the Qualitative Characteristics

7.19 Paragraphs 7.16–7.18 explain the areas where historical cost provides relevant information in terms of its confirmatory or predictive value. Application of historical cost is often straightforward, because transaction information is usually readily available. As a result amounts derived from the historical cost model are generally representationally faithful in that they represent what they purport to represent—that is, the cost to acquire or develop an asset based on actual transactions. Estimates of depreciation and impairment used in the historical cost model, particularly for non-cash-generating assets, can affect representational faithfulness. Because application of historical cost generally reflects resources consumed by reference to actual transactions, historical cost measures are verifiable, understandable and can be prepared on a timely basis.

7.20 Historical cost information is comparable to the extent that assets have the same or similar acquisition dates. Because historical cost does not reflect the impact of price changes, it is not possible to compare the amounts of assets that were acquired at different times when prices differed in a meaningful way.

7.21 In certain circumstances the application of historical cost necessitates the use of allocations—for example where:

- Several assets are acquired in a single transaction;
- Assets are constructed by the entity itself and overheads and other costs have to be attributed; and
- The use of a flow assumption, such as first-in-first-out, is necessary when many similar assets are held. To the extent such allocations are arbitrary they reduce the extent to which the resulting measurement achieves the qualitative characteristics.

Current Value Measurements

7.22 Current value measurements reflect the economic environment prevailing at the reporting date.

7.23 There are four current value measurement bases for assets:

- Market value;

- Replacement cost;
- Net selling price; and
- Value in use.

Market Value

7.24 Market value for assets is:

The amount for which an asset could be exchanged between knowledgeable, willing parties in an arm's length transaction.

7.25 At acquisition market value and historical cost will be the same, if transaction costs are ignored and the transaction is an exchange transaction. The extent to which market value meets the objectives of financial reporting and the information needs of users partially depends on the quality of the market evidence. Market evidence, in turn, depends upon the characteristics of the market in which the asset is traded. Market value is particularly appropriate where it is judged that the difference between entry and exit values is unlikely to be significant or the asset is being held with a view to sale.

7.26 In principle, market values provide useful information because they fairly reflect the value of the asset to the entity. In an open, active and orderly market (see paragraph 7.28), the asset cannot be worth less than market value as the entity can obtain that amount by selling the asset, and cannot be worth more than market value, as the entity can obtain equivalent service potential or the ability to generate economic benefits by purchasing the same asset.

7.27 The usefulness of market values is more questionable when the assumption that markets are open, active and orderly does not hold. In such circumstances it cannot be assumed that the asset may be sold for the same price as that at which it can be acquired and it is necessary to determine whether an exit price or an entry price is the more useful measure. Exit-based market values are useful for assets that are held for trading, such as certain financial instruments, but may not be useful for specialized operational assets. Furthermore, while the purchase of an asset provides evidence that the value of the asset to the entity is at least as great as its purchase price, operational factors may mean that the value to the entity may be greater. Hence market values may not reflect the value to the entity of the asset, represented by its operational capacity.

Market Values in Open, Active and Orderly Markets

7.28 Open, active and orderly markets have the following characteristics:

- There are no barriers that prevent the entity from transacting in the market;
- They are active so there is sufficient frequency and volume of transactions to provide price information; and

- They are orderly, with many well-informed buyers and sellers acting without compulsion, so there is assurance of “fairness” in determining current prices—including that prices do not represent distress sales.

An orderly market is one that is run in a reliable, secure, accurate and efficient manner. Such markets deal in assets that are identical and therefore mutually interchangeable, such as commodities, currencies and securities where prices are publicly available. In practice few, if any, markets fully exhibit all of these characteristics, but some may approach an orderly market as described.

Market Values where it cannot be assumed that Markets are Open, Active and Orderly

7.29 Markets for assets that are unique and rarely traded are not open, active and orderly: any purchases and sales are individually negotiated, and there may be a large range of prices at which a transaction might be agreed. Therefore, participants will incur significant costs to purchase or to sell an asset. In such circumstances it is necessary to use an estimation technique to estimate the price at which an orderly transaction to sell the asset would take place between market participants at the measurement date under current market conditions.

Costs of Services

7.30 Revenue from services reported in financial statements is measured on the basis of prices current in the reporting period. If assets used to provide services are measured at market value, the allocation of the cost of assets to reflect their consumption in the current reporting period is based on the current market value of the asset.

7.31 The use of market values permits a return on assets to be determined. However, public sector entities do not generally carry out activities with the primary objective of generating profits, and services are often provided in non-exchange transactions or on subsidized terms. Consequently there may be limited relevance in a reported return derived from exit-based market prices.

7.32 As noted above, revenue from providing services reported in financial statements is measured on the basis of prices current in the reporting period. Thus the surplus or deficit for a period includes price movements that take place over the period during which assets and liabilities are held, and no profit or loss is reported on the sale of an asset. Where the asset is traded on an open, active and orderly market, the existence of the market provides assurance that the entity would be able to realize the market value (and no more) at the reporting date: it is therefore unnecessary to postpone recognition of changes in value until a surplus is realized on sale. However, where assets used to provide services are not traded on open, active and orderly markets, or a close approximation to such markets, the relevance of revenue and expense related to changes in market value is more questionable.

Operational Capacity

7.33 Information on the market value of assets held to provide services in future periods is useful if it reflects the value that the entity is capable of deriving from assets by using them in providing or delivering services. However, if an exit-based market value is significantly lower than historical cost, market value is likely to be less relevant than the historical cost of such assets in providing information on operational capacity—such a market value is also likely to be less relevant than entry value-based current measures.

Financial Capacity

7.34 An assessment of financial capacity requires information on the amount that would be received on sale of an asset. This information is provided by market value.

Application of the Qualitative Characteristics

7.35 Values determined in open, active and orderly markets can be readily used for financial reporting purposes. The information will meet the qualitative characteristics—that is it will be relevant, representationally faithful, understandable, comparable, and verifiable. Under such market conditions entry and exit values can be assumed to be the same or very similar. Because it can be prepared quickly, such information is also likely to be timely.

7.36 The extent to which market values meet the qualitative characteristics will decrease as the quality of market evidence diminishes and the determination of such values relies on estimation techniques. As indicated above, exit-based market values are only likely to be relevant to assessments of financial capacity and not to assessments of the cost of services and operational capacity.

Replacement Cost

7.37 Replacement cost[13] is:

The most economic cost required for the entity to replace the service potential of an asset (including the amount that the entity will receive from its disposal at the end of its useful life) at the reporting date.

7.38 Replacement cost differs from market value because:

- In a public sector context it is explicitly an entry value that reflects the cost of replacing the service potential of an asset;
- It includes all the costs that would necessarily be incurred in the replacement of the service potential of an asset; and

13 The full term is "optimized depreciated replacement cost" to denote that it refers to the replacement of the service potential embodied in an asset and not the asset itself. (see paragraph 7.41) The term "replacement cost" is used for economy of expression in the Framework.

- It is entity specific and therefore reflects the economic position of the entity, rather than the position prevailing in a hypothetical market. For example, the replacement cost of a vehicle is less for an entity that usually acquires a large number of vehicles in a single transaction and is regularly able to negotiate discounts than for an entity that purchases vehicles individually.

7.39 Because entities usually acquire their assets by the most economic means available, replacement cost reflects the procurement or construction process that an entity generally follows. Replacement cost reflects the replacement of service potential in the normal course of operations, and not the costs that might be incurred if an urgent necessity arose as a result of some unforeseeable event, such as a fire.

7.40 Replacement cost is the cost of replacing an asset's service potential. Replacement cost adopts an optimized approach and differs from reproduction cost, which is the cost of acquiring an identical asset.[14] Although in many cases the most economic replacement of the service potential will be by purchasing an asset that is similar to that which is controlled, replacement cost is based on an alternative asset if that alternative would provide the same service potential more cheaply. For financial reporting purposes, it is therefore necessary to reflect the difference in service potential between the existing and replacement asset.

7.41 The appropriate service potential is that which the entity is capable of using or expects to use, having regard to the need to hold sufficient service capacity to deal with contingencies. Therefore, the replacement cost of an asset reflects reductions in required service capacity. For example, if an entity owns a school that accommodates 500 pupils but, because of demographic changes since its construction, a school for 100 pupils would be adequate for current and reasonably foreseeable requirements, the replacement cost of the asset is that of a school for 100 pupils.

7.42 In some cases the value that will be derived from an asset will be greater than its replacement cost. However, it would not be appropriate to measure the asset at that value, as it includes benefits from future activities, rather than service potential at the reporting date. Replacement cost represents the highest potential value of an asset, as, by definition, the entity is able to secure equivalent service potential by incurring replacement cost.

Costs of Services

7.43 Replacement cost provides a relevant measure of the cost of the provision of services. The cost of consuming an asset is equivalent to the amount of the

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14 There may be cases where replacement cost equates to reproduction cost. This is where the most economic way of replacing service potential is to reproduce the asset.

sacrifice of service potential incurred by that use. That amount is its replacement cost—the entity is able to restore its position to that prevailing immediately before the consumption of the asset by an outlay equal to replacement cost.

7.44 The costs of services are reported in current terms when based on replacement cost. Thus the amount of assets consumed is stated at the value of the assets at the time they are consumed—and not, as with historical cost, at the time they were acquired. This provides a valid basis for a comparison between the cost of services and the amount of taxes and other revenue received in the period—which are generally transactions of the current period and measured in current prices— and for assessing whether resources have been used economically and efficiently. It also provides a useful basis for comparison with other entities that report on the same basis, as asset values will not be affected by different acquisition dates, and for assessing the cost of providing services in the future and future resource needs, as future costs are more likely to resemble current costs than those incurred in the past, when prices were different (see also paragraph 7.48).

Operational Capacity

7.45 In principle, replacement cost provides a useful measure of the resources available to provide services in future periods, as it is focused on the current value of assets and their service potential to the entity.

Financial Capacity

7.46 Replacement cost does not provide information on the amounts that would be received on the sale of assets. It therefore does not facilitate an assessment of financial capacity.

Application of the Qualitative Characteristics

7.47 As noted above, replacement cost is relevant to assessments of the cost of services and operational capacity. It is not relevant to assessments of financial capacity. In some circumstances calculation of replacement cost is complex, and subjective judgments are required. These factors may reduce the representational faithfulness of replacement cost. In these circumstances the timeliness, comparability and verifiability of information prepared on a replacement cost basis may be affected, and replacement cost may be more costly than some alternatives. Replacement cost information may also not be straightforward to understand, particularly when that information reflects a reduction in required service capacity (see paragraph 7.41).

7.48 Replacement cost information is comparable within an entity as assets that provide equivalent service potential are stated at similar amounts, regardless of when those assets were acquired. In principle different entities may report similar assets at different amounts, because replacement cost is an entity-specific measure that reflects the opportunities for replacement that are available to the entity. The opportunities for replacement may be the same or similar for different public sector entities. Where they are different, the economic advantage of an entity that is able to acquire assets more cheaply is reported in financial statements through lower asset values and a lower cost of services in order to be representationally faithful.

Net Selling Price

7.49 Net selling price is:

The amount that the entity can obtain from sale of the asset, after deducting the costs of sale.

7.50 Net selling price differs from market value in that it does not require an open, active and orderly market or the estimation of a price in such a market and that it includes the entity's costs of sale. Net selling price therefore reflects constraints on sale. It is entity-specific.

7.51 The potential usefulness of measuring assets at net selling price is that an asset cannot be worth less to the entity than the amount it could obtain on sale of the asset. However, it is not appropriate as a measurement basis if the entity is able to use its resources more efficiently by employing the asset in another way, for example by using it in the delivery of services.

7.52 Net selling price is therefore useful where the most resource-efficient course available to the entity is to sell the asset. This is the case where the asset cannot provide service potential or the ability to generate economic benefits at least as valuable as net selling price. Net selling price may provide useful information where an entity is contractually obligated to sell an asset at below market value. There may be cases where net selling price can indicate a development opportunity.

Costs of Services

7.53 It is not appropriate to quantify the cost of the provision of services at net selling prices. Such an approach would involve the use of an exit value as the basis of the expense reported.

Operational Capacity

7.54 Stating assets held for use in the provision of services at net selling price does not provide information useful to an assessment of operating capacity. Net selling price shows the amount that could be derived from an asset's sale, rather than the value of the service potential that could be derived from that asset.

Financial Capacity

7.55 As noted above, an assessment of financial capacity requires information on the amount that would be received on sale of an asset. Such information is provided by the use of net selling price. However, such a measure is not relevant for assets that may yield more valuable service potential by continuing to use them to deliver services.

Application of the Qualitative Characteristics

7.56 As indicated in paragraph 7.52 net selling price provides relevant information only where the most resource-efficient course available to the entity is to sell the asset. Assessments of net selling price may be made by reference to active markets where they exist. For major assets it may be possible and cost-effective to obtain professional appraisals. Net selling price will generally provide understandable information.

7.57 In most cases where net selling price is relevant, it will achieve the qualitative characteristics of faithful representation, verifiability, and timeliness.

Value in Use

7.58 Value in use is:

The present value to the entity of the asset's remaining service potential or ability to generate economic benefits if it continues to be used, and of the net amount that the entity will receive from its disposal at the end of its useful life.

Suitability of Value in Use

7.59 Value in use is an entity-specific value that reflects the amount that can be derived from an asset through its operation and its disposal at the end of its useful life. As noted in paragraph 7.42 above, the value that will be derived from an asset is often greater than its replacement cost—it is also usually greater than its historical cost. Where this is the case, reporting an asset at its value in use is of limited usefulness, as by definition, the entity is able to secure equivalent service potential at replacement cost.

7.60 Value in use is also not an appropriate measurement basis when net selling price is greater than value in use, as in this case the most resource-efficient use of the asset is to sell it, rather than continue to use it.

7.61 Therefore, value in use is appropriate where it is less than replacement cost and greater than net selling price. This occurs where an asset is not worth replacing, but the value of its service potential or ability to generate economic benefits is greater than its net selling price. In such circumstances value in use represents the value of the asset to the entity.

7.62 Value in use is an appropriate measurement basis for the assessment of certain impairments, because it is used in the determination of the recoverable amount for an asset or group of assets.

Costs of Services, Operational Capacity, Financial Capacity

7.63 Because of its potential complexity[15], its limited applicability and the fact that its operationalization in a public sector context for non-cash-generating assets involves the use of replacement cost as a surrogate, value in use is generally inappropriate for determining the cost of services. Its usefulness to assessments of operational capacity is limited, and is only likely to be significant in the atypical circumstances where entities have a large number of assets that are not worth replacing, but their value in use is greater than their net selling price. This may be the case if, for example, an entity will discontinue provision of a service in the future, but the proceeds of immediate sale are less than the service potential embodied in the assets. Value in use does involve an estimate of the net amount that an entity will receive from disposal of the asset. However, its limited applicability reduces its relevance for assessments of financial capacity.

Application of the Qualitative Characteristics

7.64 While value in use may be used in assessments of certain impairments its relevance for financial reporting purposes is limited to the circumstances outlined in paragraph 7.61.

7.65 The extent to which value in use meets the other qualitative characteristics depends on how it is determined. In some cases, an asset's value in use can be quantified by calculating the value that the entity will derive from the asset assuming its continued use. This may be based on the future cash inflows related to the asset, or on cost savings that will accrue to the entity through its control of the asset. The calculation of value in use takes into account the time value of money and, in principle, the risk of variations in the amount and timing of cash flows.

7.66 The calculation of value in use can be complex. Assets that are employed in cash-generating activities often provide cash flows jointly with other assets. In such cases value in use can be estimated only by calculating the present value of the cash flows of a group of assets and then making an allocation to individual assets.

7.67 In the public sector, most assets are held with the primary objective of contributing to the provision of services, rather than to the generation of a commercial return: such assets are referred to as "non-cash-generating assets." Because value in use is usually derived from expected cash flows, its operationalization in such a context can be difficult. It may be inappropriate to calculate value in use on the basis of expected cash flows, because such a measure would not be faithfully representative of the value in use of such an asset to the entity. Therefore, it would be necessary to use replacement cost as a surrogate for financial reporting purposes.

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[15] See below paragraph 7.66

7.68 The method of determining value in use reduces its representational faithfulness in many cases. It also affects the timeliness, comparability, understandability and verifiability of information prepared on a value in use basis.

Measurement Bases for Liabilities

7.69 This section discusses the measurement bases for liabilities. This section does not repeat all the discussion in the section on assets. It considers the following measurement bases:

- Historical Cost;
- Cost of Fulfillment;
- Market Value;
- Cost of Release; and
- Assumption Price.

Historical Cost

7.70 Historical cost for a liability is:

The consideration received to assume an obligation, which is the cash or cash equivalents, or the value of the other consideration received at the time the liability is incurred.

7.71 Under the historical cost model initial measures may be adjusted to reflect factors such as the accrual of interest, the accretion of discount or amortization of a premium.

7.72 Where the time value of a liability is material—for example, where the length of time before settlement falls due is significant— the amount of the future payment is discounted so that, at the time a liability is first recognized, it represents the value of the amount received. The difference between the amount of the future payment and the present value of the liability is amortized over the life of the liability, so that the liability is stated at the amount of the required payment when it falls due.

7.73 The advantages and drawbacks of using the historical cost basis for liabilities are similar to those that apply in relation to assets. Historical cost is appropriate where liabilities are likely to be settled at stated terms. However, historical cost cannot be applied for liabilities that do not arise from a transaction, such as a liability to pay damages for a tort or civil damages. It is also unlikely to provide relevant information where the liability has been incurred in a non-exchange transaction, because it does not provide a faithful representation of the claims against the resources of the entity. It is also difficult to apply historical cost to liabilities that may vary in amount, such as those related to defined benefit pension liabilities.

Cost of Fulfillment

7.74 Cost of fulfillment is:

The costs that the entity will incur in fulfilling the obligations represented by the liability, assuming that it does so in the least costly manner.

7.75 Where the cost of fulfillment depends on uncertain future events, all possible outcomes are taken into account in the estimated cost of fulfillment, which aims to reflect all those possible outcomes in an unbiased manner.

7.76 Where fulfillment requires work to be done—for example, where the liability is to rectify environmental damage—the relevant costs are those that the entity will incur. This may be the cost to the entity of doing the remedial work itself, or of contracting with an external party to carry out the work. However, the costs of contracting with an external party are only relevant where employing a contractor is the least costly means of fulfilling the obligation.

7.77 Where fulfillment will be made by the entity itself, the fulfillment cost does not include any surplus, because any such surplus does not represent a use of the entity's resources. Where fulfillment amount is based on the cost of employing a contractor, the amount will implicitly include the profit required by the contractor, as the total amount charged by the contractor will be a claim on the entity's resources—this is consistent with the approach for assets, where replacement cost would include the profit required by a supplier, but no profit would be included in the replacement cost for assets that the entity would replace through self-construction.

7.78 Where fulfillment will not take place for an extended period, the cash flows need to be discounted to reflect the value of the liability at the reporting date.

7.79 Cost of fulfillment is generally relevant for measuring liabilities except in the following circumstances:

- Where the entity can obtain release from an obligation at a lower amount than cost of fulfillment, then cost of release is a more relevant measure of the current burden of a liability, just as, for an asset, net selling price is more relevant when it is higher than value in use; and
- In the case of liabilities assumed for a consideration, assumption price (see paragraphs 7.87-7.91) is more relevant when assumption price is higher than both cost of fulfillment and cost of release.

Market Value

7.80 Market value for liabilities is:

The amount for which a liability could be settled between knowledgeable, willing parties in an arm's length transaction.

7.81 The advantages and disadvantages of market value for liabilities are the same as those for assets. Such a measurement basis may be appropriate, for example, where the liability is attributable to changes in a specified rate, price or index quoted in an open, active and orderly market. However, in cases where the ability to transfer a liability is restricted and the terms on which such a transfer might be made are unclear the case for market values, even if they exist, is significantly weaker. This is particularly the case for liabilities arising from obligations in non-exchange transactions, because it is unlikely that there will be an open, active and orderly market for such liabilities.

Cost of Release

7.82 "Cost of release" is the term used in the context of liabilities to refer to the same concept as "net selling price" in the context of assets. Cost of release refers to the amount of an immediate exit from the obligation. Cost of release is the amount that either the creditor will accept in settlement of its claim, or a third party would charge to accept the transfer of the liability from the obligor. Where there is more than one way of securing release from the liability, the cost of release is that of the lowest amount—this is consistent with the approach for assets, where net selling price would not reflect the amount that would be received on sale to a scrap dealer, if a higher price could be obtained from sale to a purchaser who would use the asset.

7.83 For some liabilities, particularly in the public sector, transfer of a liability is not practically possible and cost of release will therefore be the amount that the creditor will accept in settlement of its claim. This amount will be known if it is specified in the agreement with the creditor—for example, where a contract includes a specific cancellation clause.

7.84 In some cases there may be evidence of the price at which a liability may be transferred—for example, in the case of some pension liabilities. Transferring a liability may be distinguished from entering into an agreement with another party that will fulfill the entity's obligation or bear all the costs stemming from a liability. For a liability to be transferred it is necessary that all of the creditor's rights against the entity are extinguished. If this is not the effect of an arrangement, the liability remains a liability of the entity.

7.85 In assessing whether cost of release is appropriate for measuring liabilities it is necessary to consider whether release in the envisaged manner is an option that is open to the entity in practice, having regard to any consequences of obtaining release, such as damage to the entity's reputation.

7.86 Just as net selling price is relevant only when the most resource-efficient course available to the entity is to sell the asset, so cost of release is relevant only when the most resource-efficient course is to seek immediate release from an obligation. In particular, where cost of fulfillment is lower than cost of release, cost of fulfillment provides more relevant information than cost of release, even if it is feasible to negotiate a release from the obligation in accordance with the methods for transferring a liability in paragraph 7.84.

Assumption Price

7.87 "Assumption price" is the term used in the context of liabilities to refer to the same concept as replacement cost for assets. Just as replacement cost represents the amount that an entity would rationally pay to acquire an asset, so assumption price is the amount which the entity would rationally be willing to accept in exchange for assuming an existing liability. Exchange transactions carried out on arms-length terms will provide evidence of assumption price—this is not the case for non-exchange transactions.

7.88 In the context of an activity that is carried out with a view to profit, an entity will assume a liability only if the amount it is paid to assume the liability is greater than the cost of fulfillment or release—i.e., the settlement amount. Once that assumption price has been received by the entity, the entity has an obligation to its creditor.

7.89 At the time a liability is first incurred in an exchange transaction, assumption price represents the amount that was accepted by the entity for assuming the liability—it is therefore usually reasonable to assume that assumption price is the price that the entity would rationally accept for assuming a similar liability. It would charge a higher amount, if competitive pressures allowed it to do so, but it might be unwilling to accept a lower price. Just as replacement cost is a current value so, conceptually, is assumption price. There are, however, practical problems in reflecting changes in prices in obligations that are stated at assumption price.

7.90 A consequence of stating performance obligations at the assumption price is that no surplus is reported at the time the obligation is taken on. A surplus or deficit is reported in the financial statements in the period when fulfillment (or release) takes place, as it is the difference between the revenue arising from satisfaction of the liability and the cost of settlement.

7.91 An entity may have a potential obligation that is larger than assumption price. If the entity has to seek release from a contract, the other party to the contract may be able to claim recompense for losses that it will sustain, as well as the return of any amounts paid. However, provided that the entity can settle the obligation by fulfillment, it can avoid such additional obligations and it is representationally faithful to report the obligation at no more than assumption price—this is analogous to the position where an asset will yield greater benefits than replacement cost. Under such circumstances, as explained in paragraph 7.42, replacement cost rather than value in use is the most relevant measurement basis.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

The Role of Measurement in the Conceptual Framework

BC7.1 The IPSASB decided that the initial focus of the Conceptual Framework should be on measurement of the elements for the financial statements in order to put future standard setting activities for the financial statements on a sound and transparent footing. While a few respondents to the Consultation Paper, *Measurement of Assets and Liabilities in Financial Statements* (the Consultation Paper), questioned this approach, the IPSASB considered that the original rationale for restricting the scope of this phase was sound and reaffirmed it.

The Objective of Measurement

BC7.2 The IPSASB considered whether a specific measurement objective should be developed. The IPSASB initially took the view that a separate measurement objective was unnecessary, because a measurement objective might compete with, rather than complement, the objectives of financial reporting and the qualitative characteristics. Accordingly, Exposure Draft, *Measurement of Assets and Liabilities in Financial Statements* (the Exposure Draft), proposed factors relevant to the selection of a measurement basis consistent with the objectives of financial reporting and the qualitative characteristics, but did not include a measurement objective.

BC7.3 Consistent with this approach the Exposure Draft proposed that the Conceptual Framework would not seek to identify a single measurement basis (or combination of bases) for all circumstances. The IPSASB acknowledged that proposing a single measurement basis to be used in all circumstances would clarify the relationship between different amounts reported in the financial statements—in particular, it would allow the amounts of different assets and liabilities to be aggregated to provide meaningful totals. However, the IPSASB is of the view that there is no single measurement basis that will maximize the extent to which financial statements meet the objectives of financial reporting and achieve the qualitative characteristics.

BC7.4 The Exposure Draft included an Alternative View which proposed a measurement objective on the grounds that a Conceptual Framework that does not connect the objective of measurement with the objectives of financial reporting is incomplete and would limit the ability of the IPSASB to make consistent decisions about measurement across financial reporting standards and over time. Further, in the absence of a measurement objective, the Alternative View considered that there is a risk that different and/or inappropriate measurement bases could be used to measure similar classes of assets and liabilities. The Alternative View proposed the following measurement objective:

To select those measurement attributes that most fairly reflect the financial capacity, operational capacity and cost of services of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.

BC7.5 Many respondents, while generally in favor of the approach in the Exposure Draft, supported the Alternative View. The IPSASB also acknowledges the view that the Conceptual Framework's approach to measurement should be aspirational and that the Conceptual Framework should identify a single measurement basis underpinned by an ideal concept of capital[16]. The IPSASB accepts that the operating capability concept is relevant and could be developed for public sector entities with a primary objective of delivering services. However, adoption of such a measurement objective involves a virtually explicit acknowledgement that current cost measures are superior to historical cost measures in representing operational capacity when financial position is reported. For the reasons discussed in paragraphs BC7.15-BC7.19, the IPSASB considers that historical cost measures often meet the measurement objective and therefore should be given appropriate emphasis in the Conceptual Framework.

BC7.6 Subsequently the IPSASB was persuaded by the views of those who argue that a measurement objective is necessary in order to guide standard-level decisions on the selection of measurement bases. However, the IPSASB notes that assets and liabilities contribute to the financial performance and financial position of entities in different ways and that such an assessment should be based on the extent to which they contribute to financial capacity and operational capacity. The IPSASB concluded that linking a measurement basis to an ideal concept of capital might unduly restrict the choice of measurement bases. The IPSASB therefore rejected the view that adoption of measurement objective should be based on an ideal concept of capital and reaffirmed its view that a mixed measurement approach is appropriate for standard-setting in the public sector.

BC7.7 The IPSASB considered whether the measurement objective proposed in the Alternative View was appropriate. Some argued that the proposed measurement objective was too aligned to current value measures. However the IPSASB formed a view that the reference to "cost of services" provides a sufficient link to historical cost, because the cost of services can be determined using both historical cost and current value measures. The

[16] Such concepts of capital include invested money capital, current cash equivalents and operating capability.

IPSASB therefore adopted the following measurement objective with only a minor modification from that proposed in the Alternative View:

To select those measurement bases that most fairly reflect the cost of services, operational capacity and financial capacity of the entity in a manner that is useful in holding the entity to account, and for decision-making purposes.

BC7.8 The IPSASB also notes that the disadvantages of using different measurement bases may be minimized by:

- Selecting different measurement bases only where this is justified by economic circumstances, thereby ensuring that assets and liabilities are reported on the same basis where circumstances are similar; and
- Requiring transparent presentation and disclosure to ensure that the measurement bases used and the amounts reported on each basis are clear.

Initial and Subsequent Measurement

BC7.9 A measurement basis needs to be selected both when an asset or liability is recognized for the first time—initial measurement— and when it is reported in the financial statements of a later period—subsequent measurement. Some accounting policies are expressed in a way that may suggest that different principles apply to initial and subsequent measurement. For example, an asset may initially be recognized at transaction price and subsequently at a current value. The IPSASB therefore considered whether the Conceptual Framework should discuss initial and subsequent measurement separately.

BC7.10 One reason why different measurement bases may be specified for initial and subsequent measurement is that the basis to be used for subsequent measurement is not available at the time of initial measurement. This is particularly common in the public sector where assets are sometimes contributed, or provided on subsidized terms, or in exchange for other non-cash assets. In such a case the value of the transaction may be unknown, and if the asset is to be subsequently accounted for at an entry value such as historical cost or replacement cost, another basis has to be specified for initial measurement as a surrogate for the amount at which the asset would be stated if purchased on arm’s-length terms. Surrogates may also be required for the initial measurement of assets acquired before the introduction of accrual accounting where the transaction price is not known. The use of surrogates that meet the measurement objective and the qualitative characteristics is an application of a measurement basis rather than a departure from it.

BC7.11 Another reason for an apparent difference in initial and subsequent measurement arises where an asset is to be accounted for at a current value, and the transaction price is deemed to reflect the particular current measurement basis that will be used. In such a case, specifying that the asset is to be initially recognised at transaction price makes it clear that that application of the policy will not result in the recognition of revenue and expense on initial recognition—"day one" gains or losses. In principle, the same measurement basis is used for both initial and subsequent recognition—the requirements for each are specified differently in order to assist understanding.

BC7.12 The IPSASB concluded that, in principle, the same considerations apply to initial and subsequent measurement. Accordingly the discussion in this Chapter is applicable to both situations.

Entry and Exit Values: Value in Use

BC7.13 Measurement bases can be classified according to whether they provide an entry or exit perspective. As discussed in paragraph 7.8 entry values reflect the cost of purchase and exit values reflect either:

- The economic benefits from immediate sale; or
- The amount that will be derived from the asset from its use and subsequent sale.

The IPSASB is of the view that awareness of whether a measurement basis is an entry or exit value is useful in determining which measurement basis best meets the measurement objective.

BC7.14 The IPSASB considered whether value in use should be classified as an entry value or an exit value. For a cash-generating asset value in use involves a discounted cash flow model using expected cash flows from the sale of good and services. For non-cash-generating assets value in use uses replacement cost as a surrogate—replacement cost is an entry value. This led some to express a view that for a non-cash-generating asset value in use has an entry perspective while an asset is being used and an exit perspective when sold—in this view a failure to indicate that value in use contains both entry and exit perspectives does not reflect public sector circumstances. The IPSASB acknowledges this view, but does not think that the use of replacement cost as a surrogate to calculate value in use means that value in use becomes an entry value. The IPSASB therefore concluded that value in use is an exit value for both cash-generating and non-cash-generating assets.

Measurement Bases for Assets

Historical Cost

BC7.15 Historical cost is a widely applied measurement basis in many jurisdictions. Many respondents to the Consultation Paper and the Exposure Draft advocated the continued widespread use of historical cost as a measurement basis, mostly in combination with other measurement bases. They supported this view by reference to the accountability objective and the understandability and verifiability of historical cost. They also noted that, because historical cost is widely adopted in combination with other measurement bases, its continued use avoids the costs that would arise if a future revision of a current standard that requires or permits historical cost were to require the use of a different measurement basis.

BC7.16. Some respondents considered that historical cost information provides a highly relevant basis for the reporting of the cost of services because the link between historical cost and the transactions actually undertaken by the entity is particularly important for an assessment of accountability. In particular, historical cost provides information that resource providers can use to assess the fairness of the taxes they have been assessed, or how the resources that they have otherwise contributed in a reporting period have been used.

BC7.17 The IPSASB agrees that, in many contexts, it is relevant to provide information on the transactions actually carried out by the entity, and accepts that users are interested in the cost of services based on actual transactions. Historical cost provides information on what services actually cost in the reporting period, rather than what they will cost in the future; pricing decisions based on historical cost information may promote fairness to consumers of services.

BC7.18 The IPSASB also acknowledged the views of those who consider that the use of historical cost facilitates a comparison of actual financial results and the approved budget. The IPSASB accepts that budgets may often be prepared on a historical cost basis and that where this is the case historical cost enhances comparison against budget.

BC7.19 The IPSASB also acknowledged a contrary view: that assessing and reporting the cost of providing services in terms of the value that has been sacrificed in order to provide those services provides useful information for both decision making and accountability purposes. Because historical cost does not reflect the value of assets at the time they are consumed, it does not provide information on that value in circumstances where the effect of price changes is significant. The IPSASB concluded that it is important that the Conceptual Framework responds to both these contrasting perspectives.

Market Value and Fair Value

BC7.20 The Exposure Draft did not propose fair value as a measurement basis. Rather it proposed market value, which was defined in the same way as fair value in the IPSASB's literature at the time the Conceptual Framework was developed. A number of respondents challenged the omission of fair value as a measurement basis. They pointed out that fair value is a measurement basis that is defined and used in specifying measurement requirements by many global and national standard setters and that a, definition of fair value had been used extensively in IPSASB's literature. Many supporters of fair value considered that the definition should be an exit value as defined in International Financial Reporting Standards (IFRS).[17]

BC7.21 The IPSASB's rationale for the approach proposed in the Exposure Draft was that fair value is similar to market value and the inclusion of both measurement bases could be confusing to users of financial statements. The IPSASB also noted that fair value in IFRS is explicitly an exit value—unlike the definition of fair value in the IPSASB's literature at the time the Conceptual Framework was developed. Therefore, the relevance of fair value in the public sector is likely to be primarily limited to providing information on financial capacity, rather than on providing information on operating capacity and the cost of services. In addition, in this chapter replacement cost is a measurement basis in its own right, rather than a valuation technique to determine fair value.

BC7.22 In the public sector many assets are specialized and differences in entry and exit prices are therefore significant. Where an asset will provide future services or economic benefits with a greater value than the asset's exit price, a measure reflecting exit values is not the most relevant basis. Where the most resource efficient course is to sell the asset—because the value of the services that it will provide or the expected cash flows from use is not as great as the value receivable from sale, the most relevant measurement basis is likely to be net selling price, which reflects the costs of sale and, although likely to be based on market evidence, does not assume the existence of an open, active and orderly market.

BC7.23 In considering the merits of fair value as a measurement basis, the IPSASB accepted that fair value provides a relevant basis for assessing a financial return. Where assets are stated at fair value, financial performance can be assessed in the context of the return implicit in market values. However, public sector activities are not generally carried out with a view to obtaining a financial return, so the relevance of assessing any such return is limited.

BC7.24 In finalizing the measurement chapter the IPSASB considered three main options in dealing with this issue:

- Adopt an exit value-based definition of fair value;
- Retain the definition of fair value in IPSAS prior to the development of the Conceptual Framework; or
- Include market value, rather than fair value, as a measurement basis as proposed in the Exposure Draft.

BC7.25 Adopting an exit value-based definition of fair value would have meant using a definition that is not well aligned with the objectives of most public sector

[17] IFRS 13, *Fair Value Measurement*, provides the definition of fair value.

entities—the delivery of services rather than the generation of cash flows. It is questionable whether exit value-based measures would provide relevant information for many assets held for their operational capacity and for liabilities where it is not feasible to transfer the liability.

BC7.26 Including the IPSASB's current definition of fair value or a slightly modified version of that definition in the Conceptual Framework would have meant that two global standard setters would have different conceptual definitions of the same term.

BC7.27 The IPSASB acknowledged that not including fair value as a measurement basis would have implications for the IPSASB's extant literature at the time the Conceptual Framework was finalized, because a number of IPSAS's contained fair value in measurement requirements or options.

BC7.28 On balance, the IPSASB concluded that, rather than include an exit value-based definition of fair value, or a public sector specific definition of fair value, the Conceptual Framework should include market value as a measurement basis rather than fair value. The IPSASB sees fair value as a model to represent a specific measurement outcome. The IPSASB may carry out further work at standards level to explain how the measurement bases in this chapter align with fair value, as implemented in IFRS.

Replacement Cost, Net Selling Price and Value in Use

BC7.29 Because, the objective of public sector entities is to deliver services, often in-non-exchange transactions, rather than to make profits many non-financial assets are held for operational purposes. Furthermore, many of these assets are specialized and unlikely to be purchased or sold in open, active and orderly markets. Market value facilitates an assessment of financial capacity and operational capacity where operational assets are not specialized and are traded in open, active and orderly markets. However, current measurement bases other than market value are necessary in order to provide useful information on the cost of services and operational capacity where assets are specialized and where market-based information is limited.

BC7.30 In evaluating measurement bases that provide the most useful information for specialized operational assets the IPSASB sought a basis that reflects the continuing provision of goods and services by public sector entities. The most appropriate basis for such assets is one that provides information on the cost of service potential that is attributable to an asset.

BC7.31 The IPSASB considered reproduction cost as a potential measurement basis. Reproduction cost is easily understandable. However, it reflects the cost of obtaining an identical asset, rather than the cost of replacing the service potential provided by an asset. Therefore, reproduction cost may reflect features of assets that no longer serve any economic purpose and its use may exaggerate the value of an asset. Replacement cost avoids this risk because it is based on the most economic cost required for the entity to replace the service potential of an asset. While accepting that the calculation of replacement cost may in some cases be complex and involve subjective judgments, the IPSASB concluded that replacement cost is the current value measurement basis that often best meets the measurement objective and achieves the qualitative characteristics. The IPSASB acknowledged that guidance will be necessary at standards level on the approach to implementation of replacement cost.

BC7.32 The IPSASB acknowledged that replacement cost will not always be an appropriate measurement basis for specialized operational assets. There may be circumstances where an entity no longer intends to continue to operate an asset. In such circumstances replacement cost is not a useful measurement basis, because it would not be rational for the entity to replace the service potential provided by an asset. The IPSASB therefore considered the appropriate measurement basis for such circumstances. Under these circumstances an entity-specific measurement basis that reflects the constraints on sale for an entity and provides an exit value is more appropriate. The IPSASB concluded that net selling price best meets the measurement objective. Net selling price is therefore included as a measurement basis in this chapter. Net selling price also provides information that meets the measurement objective, where an entity is contractually required, or in a binding arrangement, to sell an asset at below market value, perhaps in order to meet a social or political objective.

BC7.33 In order to provide a complete analysis of the circumstances under which public sector entities operate, the IPSASB also considered the situation where it would not be rational for an entity to seek to replace the service potential embodied in an asset, but it is still more rational for the entity to continue to operate the asset than to sell it immediately. Value in use includes the cash flows or service potential from continued operation of the asset and the proceeds of sale. The IPSASB therefore concluded that value in use should be included as a potential measurement basis. The IPSASB acknowledged that this measurement basis is not straightforward to operationalize in a non-cash-generating context, and that, in determining value in use, it might therefore be necessary to use replacement cost as a surrogate.

Fair Value Model

BC7.34 As indicated in paragraph BC7.20 the Exposure Draft did not propose fair value as a measurement basis in its own right. However, it proposed the fair value measurement model as a method of estimating a measurement where it had been determined that market value is the appropriate measurement basis, but the market is inactive or otherwise not open or orderly.

BC7.35 A minority of respondents to the Exposure Draft supported the fair value measurement model. Some of these respondents thought that the IPSASB should provide further details of its application. Others were supportive of the model, but suggested that a detailed measurement model would be inappropriate for the Conceptual Framework—some of these respondents considered that it should be addressed as a standards-level estimation technique. Many respondents put forward a view that fair value should be proposed as a measurement basis in its own right using the IFRS definition, while others wanted more detail on approaches to estimating fair value to complement its adoption as a measurement basis. Conversely, other respondents expressed a view that fair value is inappropriate for the public sector

BC7.36 The IPSASB found the views of those who considered the fair value model too low level for the Conceptual Framework persuasive. The IPSASB also accepted the view of those respondents who felt that not defining fair value as a measurement basis, but reintroducing fair value through the model was confusing. The IPSASB therefore decided not to include the fair value model in the final chapter.

Deprival Value Model

BC7.37 The Consultation Paper discussed the deprival value model as a rationale for selecting a current value basis. Some respondents expressed reservations—in particular that the model would be costly and impose a disproportionate burden on preparers to have to consider three possible measurement bases for each asset that is reported. A number of respondents also considered that it is overly complex. A view was also expressed that the deprival value model unduly exaggerates the qualitative characteristic of relevance and neglects the other qualitative characteristics.

BC7.38 Although the IPSASB recognized that the deprival value model has been adopted successfully in some jurisdictions, the IPSASB acknowledged such reservations in whole or part. The IPSASB therefore included the deprival value model in the Exposure Draft as an optional method of choosing between replacement cost, net selling price, and value in use where it had been decided to use a current measurement basis, but the appropriate basis could not be identified by reference to the objectives of financial reporting and the qualitative characteristics.

BC7.39 Although a minority of respondents to the Exposure Draft were highly supportive of the deprival value model, many respondents continued to express reservations about the model's complexity. The IPSASB also acknowledged a technical ambiguity in the deprival value model—if net selling price is higher than replacement cost a development opportunity might be indicated and that users should be provided with this information, which the deprival value model would not do. Due to these factors the IPSASB decided not to include the deprival value model in the Conceptual Framework. However, some of the insights provided by the model in its analysis of the relationship between replacement cost, net selling price and value in use have been retained —for example, that it is inappropriate to measure an asset at replacement cost if the higher of net selling price or value in use is lower than replacement cost.

Symbolic Values

BC7.40 In some jurisdictions certain assets are recognized on the statement of financial position at symbolic values, typically one unit of the presentation currency. This treatment is adopted in order to recognize assets on the face of the statement of financial position when it is difficult to obtain a valuation. Supporters of symbolic values consider that they provide useful information to users of financial statements and facilitate a linkage between asset management and accounting processes.

BC7.41 The IPSASB acknowledges that such an approach is intended to provide useful information. However, the majority of IPSASB members took the view that symbolic values do not meet the measurement objective, because they do not provide relevant information on financial capacity, operational capacity or the cost of services. The majority of the IPSASB concluded that the decision whether to recognize an item as an asset should be made following an assessment of whether the item meets the definition of an asset and recognition criteria in Chapter 5, *Elements in Financial Statements*, and Chapter 6, *Recognition in Financial Statements*. The IPSASB also accepted that, in cases where, it is impossible or very costly to obtain a valuation, it is important that the information to be provided through disclosures is carefully considered at standards level.

Measurement Bases for Liabilities

Assumption Price and Cost of Release

BC7.42 The IPSASB acknowledged the views of those who noted that, as many services are provided by public sector entities in non-exchange transactions there will often not be an assumption price. The IPSASB accepted that the circumstances under which assumption price will meet the measurement objective are limited. However, insurance and similar obligations, such as financial guarantees, are liabilities where assumption price might provide relevant and faithfully representative information. In such cases liabilities might be revalued at assumption price to reflect changes in risk premiums following initial recognition.

BC7.43 Some respondents to the Exposure Draft also questioned whether cost of release should be included. The IPSASB acknowledged that in many cases in the public sector, particularly for non-exchange transactions, there is unlikely to be a cost of release, because there will not be an external party willing to accept the transfer of a liability from the obligor for a specified amount. Even where a cost of release can be determined the external party is unlikely to accept a sum lower than cost of fulfillment in settlement. Therefore, liabilities arising from non-exchange transactions are likely to be measured at the cost of fulfillment, and this will often be the only practical and relevant measurement basis. Nevertheless the IPSASB decided to retain assumption price and cost of release as measurement bases in the Conceptual Framework as there may be limited circumstances where these measurement bases meet the measurement objective.

Other Issues

BC7.44 The Consultation Paper sought the views of respondents on the following two issues related to measurement:

- The treatment of an entity's own credit risk and changes in value attributable to changes in an entity's own credit risk; and
- Whether the measurement of an asset should reflect only the service potential relating to its existing use, or whether the measurement of an asset should include the incremental value relating to its possible alternative use.

BC7.45 The majority of respondents who commented on these issues considered that they were more appropriately dealt with at standards level rather than in the Conceptual Framework. The IPSASB concurred with this view, and these issues are accordingly not addressed in the Conceptual Framework. The IPSASB noted that where a market value is used to measure a liability it is necessary to consider the treatment of the entity's own credit risk.

CHAPTER 8: PRESENTATION IN GENERAL PURPOSE FINANCIAL REPORTS

CONTENTS

Introduction

8.1 This Chapter sets out the concepts applicable to the presentation of information in GPFRs, including financial statements of governments and other public sector entities (entities).

8.2 Presentation is linked to Chapters 1 to 4—the objectives of financial reporting, users' needs, the qualitative characteristics, constraints on information included in GPFRs and the reporting entity all influence presentation decisions. For information reported in the financial statements, presentation is also linked to the definitions of the elements, recognition criteria and measurement bases identified in Chapters 5 to 7-—for example:

- The definition of the elements affect the items that can be presented in the financial statements;
- Application of the recognition criteria affects the location of information; and
- The selection of measurement bases impacts the information presented on measurement methodologies.

Language in which Financial Statement and Other GPFRs are Issued

8.3 The language (or languages) in which financial statements and other GPFRs are issued supports achievement of the objectives of financial reporting and the qualitative characteristics. All translated versions need to be faithful to the original language version. The translated version is made available to meet the needs of users with reference to:

- Legal requirements in the entity's jurisdiction; and
- Translation costs and benefits.

Presentation

8.4 Presentation is the selection, location and organization of information that is reported in the GPFRs.

8.5 Presentation aims to provide information that contributes towards the objectives of financial reporting and achieves the qualitative characteristics while taking into account the constraints on information included in GPFRs. Decisions on selection, location and organization of information are made in response to the needs of users for information about economic or other phenomena.

8.6 Chapter 1 explains that GPFRs are likely to comprise multiple reports, each responding more directly to certain aspects of the objectives of financial reporting and matters included within the scope of financial reporting. In addition to the financial statements, GPFRs provide information relevant to, for example, assessments of an entity's service performance and the sustainability of its finances. The objectives of financial reporting, applied to the area covered by a particular report, guide presentation decisions for that report.

8.7 Presentation decisions may:

- Result in the development of a new GPFR, the movement of information between reports, or the amalgamation of existing reports; or
- Be detailed decisions on information selection, location and organization within a GPFR.

Presentation Decisions are Interlinked

8.8 Decisions on information selection, location and organization are interlinked and, in practice, are likely to be considered together. The amount or type of information selected could have implications on whether it is included in a separate report or organized into tables or separate schedules. The following three sections separately focus on each presentation decision.

Information Selection

8.9 Decisions on information selection address what information is reported:

- In the financial statements; and
- In GPFRs outside the financial statements (other GPFRs).

8.10 As Chapter 2, *Objectives and Users of General Purpose Financial Reporting*, explains, the objectives of financial reporting are to provide information about the entity that is useful to users of GPFRs for accountability and decision-making purposes. Chapter 2 describes the types of information that users need to meet the objectives of financial reporting. That description guides decisions on whether particular types of reports are needed. This Chapter focuses on the selection of information to be presented in GPFRs, including financial statements and other reports.

Information Selection—Nature of Information

Nature of Information in Financial Statements

8.11 Users' information needs identified in Chapter 2 underpin information selection for the financial statements. Those needs include information about the financial position, financial performance and cash flows of an entity in order to:

- Enable users to identify the resources of the entity and claims on those resources at the reporting date;
- Inform assessments of matters such as whether the entity has acquired resources economically, and used them efficiently and effectively to achieve its service delivery objectives; and

- Inform assessments of financial performance and the entity's liquidity and solvency.

8.12 The financial statements may also provide information that assists users in assessing the extent to which:

- An entity has met its financial objectives;
- Revenues, expenses, cash flows and financial results of the entity comply with approved budgets; and
- An entity has adhered to relevant legislation or other authority governing the raising and use of public monies.

8.13 The financial statements do not report comprehensively on an entity's service performance. However information in the financial statements may provide information relevant to the financial aspects of service performance such as information about:

- Revenue, expenses and cash flows related to services; and
- The assets and liabilities that inform users' evaluations of, for example, an entity's operational capacity or financial risks that could impact on service provision.

8.14 Other reports in GPFRs present information additional to the financial statements. Such information could, for example, include:

- Information on the sustainability of an entity's public finances;
- Financial statement discussion and analysis; or
- Service performance information.

Information Selected for Display or Disclosure

8.15 Information is selected for display or disclosure in GPFRs. Information selected for display communicates key messages in a GPFR, while information selected for disclosure makes displayed information more useful by providing detail that will help users to understand the displayed information. Disclosure is not a substitute for display.

8.16 Repetition of information in a GPFR needs to generally be avoided. However, the same information may be both displayed and disclosed. For example, a total displayed on the face of the financial statements may be repeated in the notes, where the notes provide a disaggregation of the displayed total. Similarly the same information may be presented in different GPFRs in order to address their different aims.

Information Selected for Display

8.17 Every GPFR contains key messages that are communicated, so every GPFR contains displayed information. Displayed information is kept to a concise, understandable level, so that users can focus on the key messages presented and not be distracted by detail that could otherwise obscure those messages. Displayed information is presented prominently, using appropriate presentation techniques such as clear labeling, borders, tables and graphs.

8.18 The items displayed on the face of the financial statements provide information about such matters as the reporting entity's financial position, financial performance and cash flows.

8.19 Assessment of whether an item satisfies the recognition criteria is one of the key mechanisms in determining whether information is displayed on the face of the statement of financial position or statement of financial performance and/or disclosed either in the notes or elsewhere in the GPFRs. In other cases, for example a statement of cash flows, displayed information will also support achievement of the objectives of financial reporting.

8.20 Developing requirements for the display of line items and totals involves balancing the standardization of displayed information, which facilitates understandability, with information that is tailored for entity-specific factors. The aim of both standardized display requirements and entity-specific information is to ensure that information necessary to meet the objectives of financial reporting is available for all entities, while allowing information to be displayed in a manner that reflects the nature and operations of specific entities.

Information Selected for Disclosure

8.21 Disclosed information is likely to include:

- The basis for the displayed information, such as applicable policies or methodologies;
- Disaggregations of displayed information; and
- Items that share some but not all of the aspects of displayed information—for example disclosures on items that meet some, but not all, of the characteristics of the definition of an element[18] or disclosures on items that meet the definition of an element, but not the recognition criterion.

8.22 The level of detail provided by disclosed information contributes to achievement of the objectives of financial reporting, without being excessive.

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[18] Chapter 5, *Elements in Financial Statements*, explains that other resources and other obligations that do not meet the definition of elements may be recognized in order to contribute to the objectives of financial reporting.

Disclosed information, like displayed information, is necessary for achievement of the objectives of financial reporting.

8.23 Information disclosed in the notes to the financial statements:

- Is necessary to a user's understanding of the financial statements;
- Provides information that presents the financial statements in the context of the entity and its operating environment; and
- Generally will have a clear and demonstrable relationship to information displayed on the face of the financial statement(s) to which it pertains.

8.24 Information disclosed in the notes may also include:

- Entity-related factors that could influence judgments about reported information (for example, information about related parties and controlled entities or interests in other entities);
- The basis for what is displayed (for example, information on accounting policies and measurement, including measurement methods and measurement uncertainties where applicable);
- Disaggregations of amounts displayed on the face of the statements (for example, a break-down of property, plant and equipment into different classes);
- Items that do not meet the definition of an element or the recognition criteria, but are important to an understanding of the entity's finances and ability to deliver services— for example, information about events and conditions, that might affect future cash flows or service potential, including their natures, possible effects on cash flows or service potential, probabilities of occurrence, and sensitivities to changes in conditions; and
- Information that may explain underlying trends affecting displayed totals.

Principles Applicable to Information Selection

8.25 Decisions about what information needs to be displayed and disclosed involve consideration of:

- The objectives of financial reporting;
- The qualitative characteristics and constraints on information included in GPFRs; and
- The relevant economic or other phenomena about which information may be necessary.

8.26 Information selection results in information that contributes to meeting the objectives of financial reporting, as applied to the area covered by a particular report, and provides the appropriate level of detail. Decisions on information selection involve information prioritization and summarization. Information selection avoids information overload that reduces understandability. Too much information may make it difficult for users to understand the key messages, and, consequently undermines achievement of the objectives of financial reporting.

8.27 Preparers, applying pronouncements and their professional judgment, are responsible for ensuring that information that meets the objectives of financial reporting and achieves the qualitative characteristics is provided in the GPFRs that they prepare.

8.28 Decisions on information selection require continuing and critical review. Information identified for possible selection is reviewed as it is developed and considered for presentation, with particular reference to its relevance, materiality and cost-benefit, although all the qualitative characteristics and constraints are applied to decisions on information selection. Past decisions may require reconsideration because new information may make existing information requirements redundant with the result that those items no longer achieve the qualitative characteristics and/or the constraints.

8.29 All material transactions, events, and other items reported are presented in a manner that conveys their substance rather than their legal or other form so that the qualitative characteristics of relevance and representational faithfulness are achieved.

8.30 The benefits to users of receiving information need to justify the costs to entities of collecting and presenting that information. In making this assessment it is important to consider how individual items impact on the overall view presented and the nature of the information presented. Items that may appear to have little benefit when viewed in isolation could have much greater benefit in contributing to the complete set of information presented.

8.31 Information needs to be presented on a sufficiently timely basis to enable users to hold management accountable and to inform users' decisions.

8.32 GPFRs may include additional information derived from sources other than the financial information system. The qualitative characteristics apply to such information. The date of delivery of any such additional information needs to be as close as possible to the financial statements’ reporting date, so that reported information will be timely.

Principles for Selection of Information for Display and Disclosure

8.33 Decisions about display or disclosure apply to both the financial statements and other GPFRs. The objectives of financial reporting are applied to the area covered by a particular report to guide the identification of information for display or disclosure. The identification of information for display and disclosure in a particular GPFR may involve the development of:

- Classification principles;
- A list of broad types of information that are displayed and a similar list of broad types of information that are disclosed; and/or
- Lists of specific information that preparers must display or disclose.

8.34 Decisions about selection of information to be displayed and disclosed are made:

- With reference to each other rather than in isolation; and
- To effectively communicate an integrated set of information.

8.35 Selection decisions with respect to information in other GPFRs are made after carefully considering the relationship of the other GPFRs to the financial statements.

Information Location

8.36 Decisions on information location are made about which:

- Report information is located within; and
- Component of a report information is located.

8.37 The location of information has an impact on information's contribution to achievement of the objectives of financial reporting and the qualitative characteristics. Location may affect the way that users interpret information and the comparability of information. Location may be used to:

- Convey the relative importance of information and its connections with other items of information;
- Convey the nature of information;
- Link different items of information that combine to meet a particular user need; and
- Distinguish between information selected for display and information selected for disclosure.

Principles for Allocation of Information between Different Reports

8.38 Factors relevant to decisions about allocating information between the financial statements and another GPFR include:

- *Nature*: Whether the nature of the information, for example historical versus prospective, supports including the information either in the same or a different GPFR, because of considerations related to, for example, comparability and/or understandability;

- *Jurisdiction-Specific:* Whether jurisdiction-specific factors, such as legal provisions, specify requirements on information location; and
- *Linkage:* Whether or not the additional information envisaged needs to link very closely to information already included in an existing report. The linkages between all information need to be assessed, not only linkages between new and existing information.

8.39 The factors above, which are expressed from the perspective of adding information to an existing set of information, also apply to considerations of whether the grouping of existing information could be improved, which is discussed in the section on information organization.

8.40 A separate GPFR may be necessary when:

- Additional user information needs, not satisfied by an existing report, are identified; and
- A separate GPFR to meet those needs is more likely to achieve the objectives of financial reporting and the qualitative characteristics than including information in an existing report.

Principles for Location of Information within a Report

8.41 Paragraph 8.17 of this Chapter states that displayed information is presented prominently, using appropriate presentation techniques—location is one way to achieve this. Information location within a report ensures that displayed information is given appropriate prominence and is not obscured by more detailed and extensive disclosed information.

8.42 The location of information in the financial statements contributes to communicating a comprehensive financial picture of an entity.

8.43 For the financial statements, displayed information is shown on the face of the appropriate statement, while disclosures are in the notes. Distinguishing displayed information and disclosed information through location ensures that those items that directly relate to communicating matters, such as an entity's financial position, financial performance and cash flows, can be highlighted, with further more detailed information provided through disclosure in the notes.

8.44 For other GPFRs, displayed information may either be located separately from disclosed information or located in the same area, but distinguished from disclosed information and given prominence through the use of another presentation technique.

Information Organization

8.45 Information organization addresses the arrangement, grouping and ordering of information, which includes decisions on:

- How information is arranged within a GPFR; and
- The overall structure of a GPFR.

8.46 Information organization involves a range of decisions including decisions on the use of cross-referencing, tables, graphs, headings, numbering, and the arrangement of items within a particular component of a report, including decisions on item order. How information is organized can affect its interpretation by users.

Nature of Information Relevant to Organization

8.47 Decisions about the organization of information take into account:

- Important relationships between information; and
- Whether information is for display or disclosure.

Types of Relationships

8.48 Important relationships include, but are not restricted to:

- Enhancement;
- Similarity; and
- Shared purpose.

8.49 Enhancement: Information in one place in a GPFR may be enhanced through information provided elsewhere. For example, budget, prospective and service performance information enhances information in the financial statements. Tables and graphs may be used to enhance the understanding of narrative information. Links to information reported outside the GPFRs may enhance the understandability of information reported in GPFRs.

8.50 Similarity: A relationship of similarity exists where information reported in one place is based on information reported elsewhere in the GPFRs, and the information either has not been adjusted or has had relatively minor adjustments. For example, if service performance information includes the cost of services, or the value of assets used in different services, then it may be helpful to show how those totals relate to expense and assets reported in the financial statements. Another example is the relationship between the total expense reported against budget and total expense reported in the statement of financial performance. A reconciliation between the two different amounts can enhance users' understanding of an entity's finances.

8.51 Shared purpose: A relationship of shared purpose exists where information reported in different places contributes to the same purpose. An example is where different statements and disclosures provide information needed for assessments of accountability for services delivered. Information about (a) the actual and budgeted cost of different services, (b) financial and non-financial resources used in the provision of different services, and (c) future provision of different services may be included in different places. To make the relationship between the information in different places clear, it may be appropriate to organize the information by using techniques such as common headings and referencing.

8.52 Relationships may exist between information in different:

- GPFRs;
- Components within a GPFR; and
- Parts of a single component.

Grouping of Information

8.53 The three factors noted in the section on information selection as being applicable to decisions on information location—linkage, nature of information and jurisdiction-specific considerations—also apply to considerations of whether the grouping of existing information could be improved. Decisions on effective grouping of information consider linkages between information sets, the nature of the different information sets, and, to the extent appropriate, jurisdiction-specific factors.

Principles Applicable to Information Organization

8.54 Information organization:

- Supports achievement of the objectives of financial reporting; and
- Helps reported information meet the qualitative characteristics.

8.55 Information organization:

- Helps to ensure that key messages are understandable;
- Clearly identifies important relationships;
- Gives appropriate prominence to information that conveys key messages; and
- Facilitates comparisons.

8.56 Related information is linked through the use of consistent headings, presentation order, and/or other methods appropriate to the relationship and type of information. Where links are to information reported outside the GPFRs it is important that:

- Links to information from other sources do not undermine a GPFR's achievement of the qualitative characteristics; and
- The issuance date of any such linked information is as close as possible to the financial statements' reporting date so that reported information will be timely.

Comparability

8.57 Information organization takes into account the benefits of consistent presentation over time. Consistent presentation supports users' ability to understand information and facilitates their access to information. It helps to achieve the qualitative characteristic of comparability.

Principles for Information Organization within the Financial Statements

8.58 Information displayed on the face of the financial statements is usually organized into numeric totals and sub-totals. Its organization provides a structured overview of such matters as the reporting entity's financial position, financial performance and cash flows.

8.59 For the financial statements, relationships may exist between:

- Subsets of displayed amounts or changes in displayed amounts and their impact on an entity's financial position, financial performance and/or cash flows;
- Different displayed amounts in different financial statements, which all reflect the impact of a common external event, or contribute together towards an understanding of an aspect of the entity's financial position or financial performance; and
- Displayed amounts and related note disclosures that provide information that explains or could otherwise support users' understanding of displayed items.

8.60 The organization of information in financial statements includes decisions on:

- The type and number of statements;
- Disaggregation of totals into meaningful subcategories;
- Ordering and grouping of items displayed within each statement;
- Identification of aggregates (additive and subtractive); and
- Identification of other information for inclusion on the face of the statement.

8.61 Information disclosed in the notes to the financial statements is organized so that relationships to items reported on the face of the financial statements are clear. The notes are an integral part of the financial statements.

Principles for Organization of Information within Other GPFRs

8.62 As is the case for the financial statements, information organization in other GPFRs helps to ensure that key messages conveyed by displayed information are understandable. Presentation that clearly identifies important relationships is likely to enhance the extent to which a report:

- Meets the objectives of financial reporting; and
- Achieves the qualitative characteristics.

8.63 Linking related information helps users to find important information. Some information is more understandable when organized into graphs, charts, tables, ratios or key performance indicators. Other information may be presented more effectively in narrative form. Information organization supports users' understanding of linkages between information within the same GPFR.

8.64 Information organization facilitates comparisons such as making clear when items are similar or dissimilar. Inter-period comparability is facilitated by avoiding changes to the way that information is organized for the same entity from year to year unless such changes enhance relevance and understandability. Inter-entity comparisons are facilitated when different reporting entities organize the information they present in similar ways.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the Conceptual Framework.

Concepts Applicable to Presentation in GPFRs

BC8.1 This Chapter describes concepts applicable to presentation in GPFRs, including both financial statements and additional information that enhances, complements, and supplements the financial statements. During development of this Chapter some respondents to the Consultation Paper, *Presentation in General Purpose Financial Reports* (the Consultation Paper), and the Exposure Draft, *Presentation in General Purpose Financial Reports* (the Exposure Draft), argued that the IPSASB should focus exclusively on the financial statements. Some respondents who supported the proposed more comprehensive approach considered that the resulting concepts should also be sufficiently detailed to address issues particular to financial statements.

BC8.2 The IPSASB considers that effective presentation of information in both financial statements and other GPFRs is very important in meeting the objectives of financial reporting. Presentation of information in other GPFRs raises particular challenges for the IPSASB and preparers, which makes the development of applicable concepts essential to guide the development of presentation requirements in both IPSASs and RPGs. Nevertheless, the IPSASB acknowledged the need to provide concepts that are sufficiently detailed for application to the financial statements. Therefore this Chapter describes presentation concepts for all GPFRs, and sets out the concepts applicable to financial statements in more depth.

Presentation in the Financial Statements

BC8.3 The further detail provided on financial statements responds, as noted above, to the need to ensure that the concepts proposed are applicable to the financial statements. However, this Chapter does not propose the number or type of financial statements that should be specified in IPSASs and RPGs. This approach acknowledges that, internationally, some preparers treat the "primary" financial statements as a minimum requirement, with flexibility for the preparer to add further statements—for example, additional statements that list commitments or public sector debt— to the financial statements required by IPSASs. It is also consistent with the need to avoid over-specification at the Conceptual Framework level.

BC8.4 This Chapter also does not attempt to identify a list of information that should be included in the financial statements, including the notes. This means that the presentation concepts applicable to the financial statements will remain relevant as changes occur in areas such as:

- The type of information required to adequately meet the objectives of financial reporting;
- The information technology available to present information in GPFRs; and
- The type of economic or other phenomena on which financial statements present information.

Language in which Financial Statements and Other GPFRs are issued

BC8.5 Some respondents to the Exposure Draft expressed a view that the language (or languages) in which the financial statements and other GPFRs are issued has implications for whether they will support achievement of the objectives of financial reporting and achieve the qualitative characteristics. Responding to this concern the IPSASB decided that this Chapter should address the language(s) in which GPFRs are issued. The quality of any translation will impact on the usefulness of a GPFR to users who depend on that translation. The quality of translation should be sufficient to ensure that the translated version(s) are faithful to the original language version. A faithful translation enables users to obtain the same understanding as that of an original language speaker reading the original language version.

Presentation, Display and Disclosure

BC8.6 During development of this Chapter descriptions of "presentation", "display", "disclosure", "core information", and "supporting information" were proposed. Respondents had different views on whether the descriptions were appropriate. There was significant support for the description of presentation, which covered the selection, location and organization of information. Some respondents opposed the introduction of such descriptions, because they considered that the terms "presentation" and "disclosure" have been widely used by standard setters and have generally accepted meanings. Some respondents to the Exposure Draft advocated the alignment of the IPSASB's terminology with the presentation terminology for the financial statements under development by the International Accounting Standards Board in its project to update its Conceptual Framework.

BC8.7 The IPSASB considers that having terminology that applies to all information included in GPFRs, rather than just the financial statements, may prevent full alignment with terminology that relates only to the financial statements. If the term "presentation" applies to information that conveys key messages in the financial statements, then extending the same term to other information included in GPFRs changes the meaning of the term. The term "display" signals that information that conveys key messages can be selected for either the financial statements or other information included in GPFRs.

BC8.8 The IPSASB is of the view that the distinction between presentation and disclosure used in some jurisdictions, where presentation applies to the process of reporting information on the face of a statement and disclosure applies to the process of reporting information in the notes, is inadequate for presentation concepts for GPFRs. Distinctions focused on the financial statements have limited usefulness and may be confusing for other GPFRs outside the financial statements. In the context of the financial statements, display and disclosure support a clear distinction between the process of reporting information on the face of a financial statement—display—and that of reporting information in the notes to the statements—disclosure. For these reasons the IPSASB retained the descriptions of presentation, display and disclosure proposed in the Exposure Draft with revised explanations.

BC8.9 The description of presentation proposed in the Consultation Paper included both what presentation is—information selection, location and organization—and what presentation should do—it should meet the objectives of financial reporting, the needs of users, and achieve the qualitative characteristics. After further consideration the IPSASB decided that separation of these two areas would better facilitate consideration of presentation issues. Therefore presentation is described as information selection, location and organization. There is also a description of what presentation aims to achieve, which is to provide information that contributes to the objectives of financial reporting, and achieves the qualitative characteristics while taking into account the constraints on information included in GPFRs.

BC8.10 Some respondents considered the distinction between core and supporting information proposed in the Consultation Paper implied that information in the notes to the financial statements is less important than information on the face of a statement and that it created a hierarchy. Although the IPSASB did not intend to imply that supporting information is less important than core information the IPSASB acknowledged such concerns. The IPSASB therefore reconsidered the need for a distinction between core and supporting information and concluded that incorporating the ideas related to these two types of information into the descriptions of display and disclosure within each GPFR would be more appropriate. Consequently the terms core information and supporting information were not retained in the Exposure Draft and the descriptions of display and disclosure were revised to explain what types of information would be displayed and what disclosed, without the implication that one type of information is more important than the other. This approach is reflected in this Chapter.

BC8.11 The IPSASB also considered whether all GPFRs contain both information for display and information for disclosure, and whether it is possible to have a GPFR that only contains information for disclosure. Because key messages exist for each type of GPFR, and information to convey those key messages needs to be displayed, the IPSASB concluded that all GPFRs contain both information for display and information for disclosure.

Overall Approach to Presentation

BC8.12 The Consultation Paper proposed an approach to presentation of:

- Focusing on user needs to identify presentation objectives;
- Applying the qualitative characteristics to presentation decisions; and
- Identifying separate presentation concepts—the proposed concepts were Concept 1: Select information that meets user needs, satisfies the cost-benefit test, and is sufficiently timely; Concept 2: Locate information to meet user needs; and Concept 3: Organize information to make important relationships clear and support comparability.

The Consultation Paper also proposed that presentation objectives should be established at the standards level, for application to particular reports or reporting topics.

BC8.13 Respondents generally agreed that the needs of users and achievement of the qualitative characteristics were important for presentation decisions. They supported the development of presentation objectives, but advocated that such objectives should be included in the Conceptual Framework, rather than just at standards level. Although they generally agreed that separate presentation concepts should be developed, a significant number of respondents disagreed with the three presentation concepts proposed. Some respondents disagreed with the way that the three presentation concepts emphasized particular qualitative characteristics or constraints on information included in GPFRs. They argued that other qualitative characteristics or constraints should be addressed. Others argued that the concepts added little, if anything, to the discussion of the qualitative characteristics and constraints on information included in GPFRs in Chapter 3, *Qualitative Characteristics*.

BC8.14 On balance the IPSASB concluded that a simpler, more focused approach, which directly applied the concepts in Chapters 1–4 to presentation decisions was appropriate. The IPSASB is of the view that decisions on information selection, location and organization are made in response to the needs of users for information about economic or other phenomena. Presentation decisions are made to seek to achieve the objectives of financial reporting, and they involve application of the qualitative characteristics and constraints on information included in GPFRs.

BC8.15 Presentation decisions may be either (a) decisions that may result in development of a new report, movement of information between reports, or the amalgamation of existing reports; or, (b) detailed decisions on information selection, location and organization related to information within a report. It is useful to distinguish between these two types of presentation decisions in the context of the more comprehensive scope of financial reporting discussed in Chapter 2. Both types of decisions are important and there is no intention to convey a hierarchy. The difference is one of breadth or sequencing of decisions—for example, a decision to create a new report conveys that a broad set of information will be presented. The subsequent, more specific decisions will address what is presented within that report and are equally important.

BC8.16 The need to distinguish between the display and disclosure of information is a further important aspect of the IPSASB's overall approach to presentation. An example of a detailed decision within a report is a decision about whether information should be displayed on the face of a financial statement or disclosed in the notes.

Presentation Objectives

BC8.17 As stated above, in the Consultation Paper the IPSASB proposed the development of "presentation objectives" to guide presentation decisions. Although many respondents supported identifying presentation objectives the IPSASB decided against the inclusion of presentation objectives in this Chapter, because they would create an unnecessary additional layer of objectives beneath the objectives of financial reporting in Chapter 2. Development of a second layer of presentation objectives could be confusing and detract from the objectives of financial reporting. This approach was proposed in the Exposure Draft and was generally supported by respondents.

Application of the Qualitative Characteristics and Constraints

BC8.18 During development of this Chapter many respondents supported application of the qualitative characteristics to presentation decisions. However, some respondents expressed reservations that the constraints on information included in GPFRs had not been properly integrated into the overall approach to presentation. The IPSASB agrees that the constraints apply to presentation decisions. They are therefore included in the overall approach to presentation and in subsequent discussion of the application of the three presentation decisions.

Presentation Concepts

BC8.19 After considering respondents' concerns about the three presentation concepts proposed in the Consultation Paper and possible further changes to address those concerns, the IPSASB concluded that the ideas in the three concepts were adequately addressed through application of the qualitative characteristics and constraints on information included in GPFRs to presentation decisions. Therefore, in the Exposure Draft the IPSASB replaced the three presentation concepts proposed in the Consultation Paper with a revised description of the application of the qualitative characteristics and constraints on information included in GPFRs to presentation decisions. Respondents to the Exposure Draft generally supported the direct application of the concepts established in Chapters 1–4, rather than development of an intermediary set of either presentation concepts or presentation objectives.

Information Organization: Links to External Information

BC8.20 Chapter 2 of the Conceptual Framework explains that users of GPFRs may also need to consider information from other sources, including reports on current and anticipated economic conditions, budgets and forecasts, and information about government policy initiatives not reported in GPFRs. The IPSASB considered whether GPFRs should include links to such information. Although the IPSASB acknowledged the risk that such information may not achieve the qualitative characteristics, the IPSASB concluded that such links can support understandability. Therefore, provided information from external sources does not undermine achievement of the qualitative characteristics the IPSASB concluded that GPFRs might include links to such information.

Appendix

Conceptual Framework Due Process Publications

Title	**Date Issued**	**Consultation Period Ended**
Consultation Paper, *The Objectives of Financial Reporting; The Scope of Financial Reporting; The Qualitative Characteristics of Information Included in General Purpose Financial Reports; The Reporting Entity*	September 30, 2008	March 30, 2009
Consultation Paper, *Elements and Recognition in Financial Statements*	December 15, 2010	June 14, 2011
Consultation Paper, *Measurement of Assets and Liabilities in Financial Statements*	December 15, 2010	June 14, 2011
Exposure Draft 1, *Role, Authority and Scope; Objectives and Users; Qualitative Characteristics; and Reporting Entity*	December 15, 2010	June 14, 2011
Exposure Draft, *Key Characteristics of the Public Sector with Potential Implications for Financial Reporting*	April 29, 2011	August 31, 2011
Consultation Paper, *Presentation in General Purpose Financial Reports*	January 29, 2012	May 31, 2012
Exposure Draft 2, *Elements and Recognition in Financial Statements*	November 7, 2012	April 30, 2013
Exposure Draft 3, *Measurement of Assets and Liabilities in Financial Statements*	November 7, 2012	April 30, 2013
Exposure Draft 4, *Presentation in General Purpose Financial Reports*	April 17, 2013	August 15, 2013

IPSAS 1—PRESENTATION OF FINANCIAL STATEMENTS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 1 (Revised 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 the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 1—PRESENTATION OF FINANCIAL STATEMENTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 1, *Presentation of Financial Statements* was issued in May 2000.

In December 2006 the IPSASB issued a revised IPSAS 1.

Since then, IPSAS 1 has been amended by the following IPSASs:

- IPSAS 38, *Disclosure of Interests in Other Entities* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2014* (issued Janauary 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- IPSAS 28, *Financial Instruments: Presentation* (issued January 2010)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)
- IPSAS 30, *Financial Instruments: Disclosures* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 1

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
4	Amended	IPSAS 35 January 2015
7	Amended	IPSAS 35 January 2015
7A	New	IPSAS 28 January 2010
12	Amended	IPSAS 35 January 2015
21	Amended	Improvements to IPSASs January 2015
53	Amended	Improvements to IPSASs January 2015

Paragraph Affected	How Affected	Affected By
53A	New	Improvements to IPSASs January 2015
54	Amended	Improvements to IPSASs January 2015
75	Amended	IPSAS 30 January 2010
79	Amended	IPSAS 29 January 2010 Improvements to IPSASs January 2010
80	Amended	Improvements to IPSASs November 2010
82	Amended	IPSAS 29 January 2010 Improvements to IPSASs January 2010 Improvements to IPSASs November 2010
88	Amended	IPSAS 35 January 2015
95	Amended	IPSAS 35 January 2015
95A	New	IPSAS 28 January 2010
97	Amended	IPSAS 35 January 2015
101	Amended	IPSAS 29 January 2010
103	Amended	IPSAS 35 January 2015
118	Amended	IPSAS 35 January 2015
129	Amended	IPSAS 30 January 2010
134	Amended	IPSAS 38 January 2015
135	Amended	IPSAS 35 January 2015
139	Amended	IPSAS 38 January 2015
148	Amended	IPSAS 30 January 2010
148A	New	IPSAS 30 January 2010
148B	New	IPSAS 30 January 2010
148C	New	IPSAS 30 January 2010

Paragraph Affected	**How Affected**	**Affected By**
148D	New	IPSAS 28 January 2010
150	Amended	IPSAS 28 January 2010
151	Deleted	IPSAS 33 January 2015
152	Deleted	IPSAS 33 January 2015
153A	New	Improvements to IPSASs January 2010
153B	New	IPSAS 28 January 2010
153C	New	IPSAS 30 January 2010
153D	New	Improvements to IPSASs November 2010
153E	New	Improvements to IPSASs January 2015
153F	New	IPSAS 33 January 2015
153G	New	IPSAS 38 January 2015 IPSAS 35 January 2015
154	Amended	IPSAS 33 January 2015

December 2006

IPSAS 1—PRESENTATION OF FINANCIAL STATEMENTS

CONTENTS

International Public Sector Accounting Standard 1, *Presentation of Financial Statements*, is set out in paragraphs 1–155. All the paragraphs have equal authority. IPSAS 1 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the 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 including those that present consolidated financial statements in accordance with IPSAS 35, *Consolidated Financial Statements* and those that present separate financial statements, in accordance with IPSAS 34, *Separate Financial Statements*.

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 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:**

   <u>**Accrual basis**</u> **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.

<u>Assets</u> 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.

<u>Contributions from owners</u> 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 (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or**

(b) **Can be sold, exchanged, transferred, or redeemed.**

<u>Distributions to owners</u> 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.

An <u>economic entity</u> is a controlling entity and its controlled entities.

<u>Expenses</u> 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.

<u>Government Business Enterprise</u> 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.**

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

<u>Liabilities</u> 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.

<u>Material</u> 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.

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

<u>Notes</u> 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.

<u>Revenue</u> 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 Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

7A. The following terms are described in IPSAS 28, *Financial Instruments: Presentation* and are used in this Standard with the meaning specified in IPSAS 28:

(a) Puttable financial instrument classified as an equity instrument (described in paragraphs 15 and 16 of IPSAS 28);

(b) An instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument (described in paragraphs 17 and 18 of IPSAS 28).

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 that 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 35, 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. Although 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;**

(f) **Notes, comprising a summary of significant accounting policies and other explanatory notes; and**

(g) **Comparative information in respect of the preceeding period as specified in paragraphs 53 and 53A of IPSAS 1.**

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 that 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:

- 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

- 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 (a) performance indicators, (b) statements of service performance, (c) program reviews, and (d) 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 Standard, 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 Standard, 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 Standard, 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 Standard; 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 Standard, 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 Standard.

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 Standard 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 (a) current and expected performance, (b) potential and announced restructurings of organizational units, (c) estimates of revenue or the likelihood of continued government funding, and (d) 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 paragraphs 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 (a) to understand the transactions, other events and conditions that have occurred, and (b) 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

Minimum Comparative Information

53. **Except when an IPSAS permits or requires otherwise, an entity shall present comparative information in respect of the preceding period for all amounts reported in the financial statements. An entity shall include comparative information for narrative and descriptive information if it is relevant to understanding the current period's financial statements.**

53A. **An entity shall present, as a minimum, one statement of financial position with comparative information for the preceding period, one statement of financial performance with comparative information for the preceding period, one cash flow statement with comparative information for the preceding period and one statement of changes in net assets/equity with comparative information for the preceding period, and related notes.**

54. In some cases, narrative information provided in the financial statements for the preceding period(s) continues to be relevant in the current period. For example, an entity discloses in the current period details of a legal dispute, the outcome of which was uncertain at the end of the preceding period and is yet to be resolved. Users may benefit from the disclosure of information that the uncertainty existed at the end of the preceding period and from disclosure of information 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 (a) statement of financial position, (b) statement of financial performance, (c) statement of changes in net assets/equity, and (d) 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.

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 (a) users be aware that the amounts shown for the current period and comparative amounts are not comparable, and (b) 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 30, *Financial Instruments: Disclosures*, 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 trading (examples include some financial assets classified as held for trading in accordance with IPSAS 29, *Financial Instruments: Recognition and Measurement*) 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 (see paragraph 84). Terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification.**

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 some financial liabilities classified as held for trading in accordance with IPSAS 29, bank overdrafts, and the current portion of non-current financial liabilities, dividends or similar distributions 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) **Non-controlling 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) **Non-controlling interests.**

95A. **If an entity has reclassified:**

(a) **A puttable financial instrument classified as an equity instrument; or**

(b) **An instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument;**

between financial liabilities and net assets/equity, it shall disclose the amount reclassified into and out of each category (financial liabilities

or net assets/equity), and the timing and reason for that reclassification.

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 non-controlling interest in the net assets/equity of the entity. For example, at the 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 the number 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 IPSASs deal with items that may meet definitions of revenue or expense set out in this Standard, but are usually excluded from surplus or deficit. Examples include revaluation surpluses (see IPSAS 17), particular (a) gains and losses arising on translating the financial statements of a foreign operation (see IPSAS 4), and (b) gains or losses on remeasuring available-for-sale financial assets (guidance on measurement of financial assets can be found in IPSAS 29).

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 non-controlling 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, 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	X	
Total expenses		(X)
Surplus		X

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	(X)
Surplus	X

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 25, *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 non-controlling 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, 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 IPSASs 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 reflect 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 (a) the ability of the entity to generate cash and cash equivalents, and (b) 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 30).

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 an entity applies the fair value or cost model to its investment property (see IPSAS 16, *Investment Property*.) Some IPSASs specifically require disclosure of particular accounting policies, including choices made by management between different policies allowed in those Standards. 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 non-controlling 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:

- Whether assets are investment properties;
- Whether agreements for the provision of goods and/or services that involve the use of dedicated assets are leases;
- Whether, in substance, particular sales of goods are financing arrangements and therefore do not give rise to revenue; and
- 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 IPSASs. For example, IPSAS 38, *Disclosure of Interests in Other Entities*, requires an entity to disclose the judgments it has made in determining whether it controls another entity. 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 (a) the key assumptions concerning the future, and (b) 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 (a) the recoverable amount of certain classes of property, plant, and equipment, (b) the effect of technological obsolescence on inventories, and (c) 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 IPSASs. For example, IPSAS 19 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. IPSAS 30 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.

Capital

148A. **An entity shall disclose information that enables users of its financial statements to evaluate the entity's objectives, policies, and processes for managing capital.**

148B. To comply with paragraph 148A the entity discloses the following:

(a) Qualitative information about its objectives, policies, and processes for managing capital, including (but not limited to):

(i) A description of what it manages as capital;

(ii) When an entity is subject to externally imposed capital requirements, the nature of those requirements and how those requirements are incorporated into the management of capital; and

(iii) How it is meeting its objectives for managing capital.

(b) Summary quantitative data about what it manages as capital. Some entities regard some financial liabilities (e.g., some forms of subordinated debt) as part of capital. Other entities regard capital as excluding some components of equity (e.g., components arising from cash flow hedges).

(c) Any changes in (a) and (b) from the previous period.

(d) Whether during the period it complied with any externally imposed capital requirements to which it is subject.

(e) When the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

These disclosures shall be based on the information provided internally to the entity's key management personnel.

148C. An entity may manage capital in a number of ways and be subject to a number of different capital requirements. For example, a conglomerate may include entities that undertake insurance activities and banking activities, and those entities may also operate in several jurisdictions. When an aggregate disclosure of capital requirements and how capital is managed would not provide useful information or distorts a financial statement user's understanding of an entity's capital resources, the entity shall disclose separate information for each capital requirement to which the entity is subject.

Puttable Financial Instruments Classified as Net Assets/Equity

148D. **For puttable financial instruments classified as equity instruments, an entity shall disclose (to the extent not disclosed elsewhere):**

(a) **Summary quantitative data about the amount classified as net assets/equity;**

(b) **Its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;**

(c) **The expected cash outflow on redemption or repurchase of that class of financial instruments; and**

(d) **Information about how the expected cash outflow on redemption or repurchase was determined.**

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;**

(d) **The name of the controlling entity and the ultimate controlling entity of the economic entity (where applicable); and**

(e) **If it is a limited life entity, information regarding the length of its life.**

Transitional Provisions

151. [Deleted]

152. [Deleted]

Effective Date

153. **An entity shall apply this 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.**

153A. **Paragraphs 79 and 82 were amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2011, it shall disclose that fact.**

153B. **IPSAS 28 amended paragraph 150 and inserted paragraphs 7A, 95A, and 148D. An entity shall apply the amendments for annual financial statements covering periods beginning on or after January 1, 2013. If an entity applies IPSAS 28 for a period beginning before January 1, 2013, the amendments shall also be applied for that earlier period.**

153C. **IPSAS 30 amended paragraphs 75, 129, and 148 and inserted paragraphs 148A–148C. An entity shall apply the amendments for annual financial statements covering periods beginning on or after January 1, 2013. If an entity applies IPSAS 30 for a period beginning before January 1, 2013, the amendments shall also be applied for that earlier period.**

153D. **Paragraph 80 was amended by *Improvements to IPSASs* issued in November 2010. An entity shall apply that amendment for annual financial statements covering periods beginning on or after**

January 1, 2012. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2012, it shall disclose that fact.

153E. **Paragrahs 21, 53 and 54 were amended and paragraph 53A added by *Improvements to IPSASs 2014,* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2015. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2015, it shall disclose that fact.**

153F. **Paragraphs 151, 152 and 154 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

153G. **IPSAS 35, *Consolidated Financial Statements* and IPSAS 38, *Disclosure of Interests in Other Entities*, issued in January 2015, amended paragraphs 4, 7, 12, 88(n), 95(d), 97, 103, 118(c), 134, 135 and 139. An entity shall apply those amendments when it applies IPSAS 35, and IPSAS 38.**

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

Withdrawal of IPSAS 1 (2000)

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

Appendix A

Qualitative Characteristics of Financial Reporting

This Appendix is an integral part of IPSAS 1.

The IPSASB issued Chapter 3, *Qualitative Characteristics* of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Framework*) in January 2013. Chapter 3 details the qualitative characteristics (QCs) of information included in general purpose financial reports (GPFRs) and the pervasive constraints on information included in GPFRs.

The QCs in this Appendix continue to apply to existing pronouncements unless stated otherwise. The QCs in the *Framework* will be applied in the development of future pronouncements. Potential changes to pronouncements resulting from the issue of the *Framework*, including the potential withdrawal of this Appendix, will be considered following completion of the *Framework*.

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 that 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 be 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, (a) the creation of hidden reserves or excessive provisions, (b) the deliberate understatement of assets or revenue, or (c) 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:

(a) Comparison of financial statements of different entities; and

(b) 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.

Appendix B

Amendments to Other IPSASs

In IPSASs applicable at January 1, 2008:

(a) References to “net surplus” or “net deficit” are amended to “surplus” or “deficit”; and

(b) References to “notes to the financial statements” are amended to “notes.”

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 1.

Revision of IPSAS 1 as a result of the IASB's General Improvements Project 2003

Background

BC1. The IPSASB's IFRS convergence program is an important element in the IPSASB's work program. The IPSASB 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[1] 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 Public Sector Committee (PSC),[2] 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 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). In those cases where

[1] 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.

[2] 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 IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the 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 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.*[3] This difference reflected the public sector view of what constituted an extraordinary item for public sector entities.

BC10. This Standard 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. 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

3 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."

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.

Revision of IPSAS 1 as a result of the IASB's *Improvements to IFRSs* issued in 2008

BC11. The IPSASB reviewed the revisions to IAS 1 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendments.

Revision of IPSAS 1 as a result of the IASB's *Improvements to IFRSs* issued in 2009

BC12. The IPSASB reviewed the revisions to IAS 1 included in the *Improvements to IFRSs* issued by the IASB in April 2009 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendment.

Revision of IPSAS 1 as a result of IASB's *Improvements to IFRSs* issued May 2012

BC13. The IPSASB reviewed the revisions to IAS 1 included in the *Improvements to IFRSs* issued by the IASB in May 2012 and generally concurred that there was no public sector specific reason for not adopting certain amendments. The IPSASB noted some of the amendments impact IFRS 1, *First-time Adoption of International Financial Reporting Standards* and IAS 34, *Interim Financial Reporting* for which equivalent standards do not exist in IPSASs, and therefore such amendments have been excluded. Further, a portion of the amendments propose changes related to presenting a statement of financial position at the beginning of a preceding period for retrospective changes resulting from accounting policy changes, restatements and reclassifications. Presentation of an opening statement of financial position is currently not a requirement of IPSAS 1 and introducing changes related to these IASB amendments, is not considered minor and therefore these have been excluded. A further portion of the amendment related to presenting additional comparative information was not considered a minor change and has also been excluded.

Implementation Guidance

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

Illustrative Financial Statement Structure

IG1. This 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 statement of 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**
ASSETS		
Current assets		
Cash and cash equivalents	X	X
Receivables	X	X
Inventories	X	X
Prepayments	X	X
Other current assets	X	X
	X	X
Non-current assets		
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
	X	X
Total assets	X	X
LIABILITIES		
Current liabilities		
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
	X	X
Non-current liabilities		
Payables	X	X
Long-term borrowings	X	X
Long-term provisions	X	X
Employee benefits	X	X
Superannuation	X	X
	X	X
Total liabilities	X	X
Net assets	X	X
NET ASSETS/EQUITY		
Capital contributed by		
Other government entities	X	X
Reserves	X	X
Accumulated surpluses/(deficits)	X	X
Non-controlling interest	X	X
Total net assets/equity	X	X

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
Revenue		
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
Total revenue	X	X
Expenses		
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)
Total expenses	(X)	(X)
Share of surplus of associates*	X	X
Surplus/(deficit) for the period	X	X
Attributable to:		
Owners of the controlling entity	X	X
Non-controlling interests	X	X
	X	X

* This means the share of associates' surplus attributable to owners of the associates, i.e., it is after tax and non-controlling 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**
Revenue		
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
Total Revenue	X	X
Expenses		
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)
Total Expenses	(X)	(X)
Share of surplus of associates	X	X
Surplus/(deficit) for the period	(X)	X
Attributable to:		
Owners of the controlling entity	(X)	X
Non-controlling interest	(X)	X
	(X)	X

* 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.

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					Non-controlling interest	Total net assets/ equity
	Contributed Capital	**Other Reserves**[4]	**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
Changes in net assets/equity for 20X1							
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
Total recognized revenue and expense for the period		X	(X)	X	X	X	X

4 Other reserves are analyzed into their components, if material.

(in thousands of currency units)	Attributable to owners of the controlling entity					Non-controlling interest	Total net assets/ equity
	Contributed Capital	Other Reserves[4]	Translation Reserve	Accumulated Surpluses/ (Deficits)	Total		
Balance at December 31, 20X1 carried forward	X	X	(X)	X	X	X	X
Balance at December 31, 20X1 brought forward	X	X	(X)	X	X	X	X
Changes in net assets/equity for 20X2							
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)
Total recognized revenue and expense for the period		(X)	(X)	(X)	(X)	(X)	(X)
Balance at December 31, 20X2	X	X	(X)	X	X	X	X

Comparison with IAS 1

IPSAS 1 is drawn primarily from IAS 1 (2003) and includes amendments made to IAS 1 as part of the *Improvements to IFRSs* issued in May 2008 and April 2009 respectively. 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 Standard 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," and "net assets/equity" in IPSAS 1. The equivalent terms in IAS 1 are "income statement," 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 Standard" 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 that 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 A.

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 Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IPSAS 2—CASH FLOW STATEMENTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 2, *Cash Flow Statements* was issued in May 2000.

Since then, IPSAS 2 has been amended by the following IPSASs:

- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* (issued December 2006)
- IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* (issued December 2006)
- *Improvements to IPSASs* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 2

Paragraph Affected	How Affected	Affected By
8	Amended	IPSAS 35 January 2015
22	Amended	Improvements to IPSASs January 2010 Improvements to IPSASs November 2010
25	Amended	Improvements to IPSASs November 2010
27	Amended	Improvements to IPSASs November 2010
30	Amended	IPSAS 35 January 2015 Improvements to IPSASs November 2010
36	Amended	IPSAS 4 December 2006
37	Amended	IPSAS 4 December 2006

Paragraph Affected	How Affected	Affected By
8	Amended	IPSAS 35 January 2015
40[1]	Deleted	IPSAS 3 December 2006 Improvements to IPSASs November 2010
41	Deleted	IPSAS 3 December 2006
42	Amended	Improvements to IPSASs November 2010
43	Amended	Improvements to IPSASs November 2010
47	Amended	IPSAS 37 January 2015 Improvements to IPSASs November 2010
48	Amended	IPSAS 37 January 2015
50A	New	IPSAS 35 January 2015
52A	New	IPSAS 35 January 2015
52B	New	IPSAS 35 January 2015
61	Amended	IPSAS 37 January 2015
63A	New	Improvements to IPSASs January 2010
63B	New	Improvements to IPSASs November 2010
63C	New	IPSAS 33 Janaury 2015
63D	New	IPSAS 37 January 2015 IPSAS 35 January 2015
64	Amended	IPSAS 33 Janaury 2015
IE	Amended	IPSAS 3 December 2006

[1] Subsequent paragraphs have been renumbered.

May 2000

IPSAS 2—CASH FLOW STATEMENTS

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Illustrative Examples

Comparison with IAS 7

International Public Sector Accounting Standard 2, *Cash Flow Statements*, is set out in the objective and paragraphs 1–64. All the paragraphs have equal authority. IPSAS 2 should be read in the context of its objective, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

The cash flow statement identifies (a) the sources of cash inflows, (b) the items on which cash was expended during the reporting period, and (c) 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 that classifies cash flows during the period from operating, investing, and financing activities.

Scope

1. **An entity that prepares and presents financial statements under the accrual basis of accounting shall prepare a cash flow statement in accordance with the requirements of this Standard, and shall 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 (a) assessing the entity's cash flows, (b) assessing the entity's compliance with legislation and regulations (including authorized budgets where appropriate), and (c) 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.**

4. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs 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 (a) the future cash requirements of the entity, (b) its ability to generate cash flows in the future, and (c) its ability 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:**

<u>Cash</u> comprises cash on hand and demand deposits.

<u>Cash equivalents</u> 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.

<u>Cash flows</u> are inflows and outflows of cash and cash equivalents.

<u>Control:</u> An entity controls another entity when the entity is exposed, or has rights, to variable benefits from its involvement with the other entity and has the ability to affect the nature and amount of those benefits through its power over the other entity.

<u>Financing activities</u> are activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.

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

<u>Operating activities</u> are the activities of the entity that are not investing or financing activities.

<u>Reporting date</u> means the date of the last day of the reporting period to which the financial statements relate.

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

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 that 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 that 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 shall 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 that 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 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 that is included in surplus or deficit. The cash flows relating to such transactions are cash flows from investing activities. However, cash payments to construct or acquire assets held for rental to others and subsequently held for sale as described in paragraph 83A of IPSAS 17, *Property, Plant, and Equipment* are cash flows from operating activities. The cash receipts from rents and subsequent sales of such assets are also cash flows from operating 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 that are intended to contribute to the entity's future service delivery. Only cash outflows that result in a recognized asset in the statement of financial position are eligible for classification as investing activities. 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 shall 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 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 that (a) may be useful in estimating future cash flows, and (b) 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 surplus or deficit from ordinary activities for the effects of:

(a) Changes during the period in inventories and operating receivables and payables;

(b) Non-cash items such as depreciation, provisions, deferred taxes, unrealized foreign currency gains and losses, undistributed surpluses of associates, and non-controlling interests; and

(c) All other items for which the cash effects are investing or financing cash flows.

(d) [Deleted]

Reporting Cash Flows from Investing and Financing Activities

31. **An entity shall 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 that 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, if those cash flows had been reported at end of period exchange rates.

Interest and Dividends or Similar Distributions

40. **Cash flows from interest and dividends or similar distributions received and paid shall each be disclosed separately. Each shall 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 or similar distributions 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 or similar

distributions received may be classified as operating cash flows because they enter into the determination of surplus or deficit. Alternatively, interest paid and interest and dividends or similar distributions 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 or similar distributions paid may be classified as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, dividends or similar distributions 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 shall be separately disclosed and shall 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, a joint venture, 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 or similar distributions and advances.

48. An entity that reports its interest in an associate or a joint venture using the equity method includes in its cash flow statement the cash flows in respect

of its investments in an associate or joint venture, and distributions and other payments or receipts between it and the associate or joint venture.

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 shall be presented separately and classified as investing activities.**

50. **An entity shall 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.**

50A. An investment entity, as defined in IPSAS 35, *Consolidated Financial Statements*, need not apply paragraphs 50(c) or 50(d) to an investment in a controlled entity that is required to be measured at fair value through surplus or deficit. A controlling entity that is not itself an investment entity need not apply paragraphs 50(c) or 50(d) to an investment in a controlled investment entity to the extent that investment is measured at fair value through surplus or deficit.

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 of 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.

52A. Cash flows arising from changes in ownership interests in a controlled entity that do not result in a loss of control shall be classified as cash flows from financing activities, unless the controlled entity is held by an investment entity, as defined in IPSAS 35, or through a controlled investment entity, and is required to be measured at fair value through surplus or deficit.

52B. Changes in ownership interests in a controlled entity that do not result in a loss of control, such as the subsequent purchase or sale by a controlling entity of a controlled entity's equity instruments, are accounted for as equity transactions (see IPSAS 35), unless the controlled entity is held by an investment entity, or through a controlled investment entity, and is required to be measured at fair value through surplus or deficit. Accordingly, the resulting cash flows are classified in the same way as other transactions described in paragraph 26.

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 that 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 shall be excluded from a cash flow statement. Such transactions shall 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 shall disclose the components of cash and cash equivalents, and shall 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 that 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 shall 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; and

    (b) [Deleted]

    (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. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after July 1, 2001. Earlier application is encouraged. If an entity applies this Standard for a period beginning before July 1, 2001, it shall disclose that fact.**

63A. **Paragraph 22 was amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2011, it shall disclose that fact and apply paragraph 83A of IPSAS 17.**

63B. **Paragraph 25 was amended by *Improvements to IPSASs* issued in November 2010. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2012. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2012, it shall disclose that fact.**

63C. **Paragraph 64 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

63D. **IPSAS 35, *Consolidated Financial Statements* and IPSAS 37, *Joint Arrangements*, issued in January 2015, amended paragraphs 8 and 30(b), 47, 48 and 61(b), and added paragraphs 50A, 52A and 52B. An entity shall apply those amendments when it applies IPSAS 35 and IPSAS 37.**

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

Basis for Conclusions

Revision of IPSAS 2 as a result of the IASB's *Improvements to IFRSs* issued in 2009

BC1. The IPSASB reviewed the revisions to IAS 7 included in the Improvements to IFRSs issued by the IASB in April 2009 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendment.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 2.

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

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**
CASH FLOWS FROM OPERATING ACTIVITIES		
Receipts		
Taxation	X	X
Sales of goods and services	X	X
Grants	X	X
Interest received	X	X
Other receipts	X	X
Payments		
Employee costs	(X)	(X)
Superannuation	(X)	(X)
Suppliers	(X)	(X)
Interest paid	(X)	(X)
Other payments	(X)	(X)
Net cash flows from operating activities	X	X
CASH FLOWS FROM INVESTING ACTIVITIES		
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)
Net cash flows from investing activities	(X)	(X)
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from borrowings	X	X
Repayment of borrowings	(X)	(X)
Distribution/dividend to government	(X)	(X)
Net cash flows from financing activities	X	X
Net increase/(decrease) in cash and cash equivalents	X	X
Cash and cash equivalents at beginning of period	X	X
Cash and cash equivalents at end of period	X	X

Notes to the Cash Flow Statement

(a) *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash on hand, 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:

(in thousands of currency units)	**20X2**	**20X1**
Cash on hand and balances with banks	X	X
Short-term investments	X	X
	X	X

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 Surplus/(Deficit)*

(in thousands of currency units)	**20X2**	**20X1**
Surplus/(deficit)	X	X
Non-cash movements		
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)
Net cash flows from operating activities	**X**	**X**

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**
CASH FLOWS FROM OPERATING ACTIVITIES		
Surplus/(deficit)	X	X
Non-cash movements		
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)
Net cash flows from operating activities	**X**	**X**

Notes to the Cash Flow Statement

(a) *Cash and Cash Equivalents*

Cash and cash equivalents consist of cash on hand, 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:

(in thousands of currency units)	**20X2**	**20X1**
Cash on hand and balances with banks	X	X
Short-term investments	X	X
	X	X

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* and includes an amendment made to IAS 7 as part of the *Improvements to IFRSs* issued in April 2009. 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 "revenue," "statement of financial performance," and "net assets/equity" in IPSAS 2. The equivalent terms in IAS 7 are "income," "income statement," 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 Illustrative Examples accompanying IPSAS 2 do 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 Financial Reporting Standards (IFRS) Foundation.

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E-mail: publications@ifrs.org

Internet: www.ifrs.org

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

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* was issued in May 2000.

In December 2006 the IPSASB issued a revised IPSAS 3.

Since then, IPSAS 3 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- IPSAS 31, *Intangible Assets* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 3

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
Heading above IN11	Amended	Improvements to IPSASs November 2010
9	Amended	Improvements to IPSASs January 2010
11	Amended	Improvements to IPSASs January 2010
14	Amended	Improvements to IPSASs January 2010
22	Amended	IPSAS 31 January 2010
59A	New	Improvements to IPSASs January 2010
59B	New	IPSAS 33 January 2015
60	Amended	IPSAS 33 January 2015

December 2006

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

CONTENTS

International Public Sector Accounting Standard 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, is set out in paragraphs 1–61. All the paragraphs have equal authority. IPSAS 3 should be read in the context of its objective, the Basis for Conclusions, the *Preface to the International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3 provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the criteria for selecting and changing accounting policies, together with the (a) accounting treatment and disclosure of changes in accounting policies, (b) changes in accounting estimates, and (c) 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, *Presentation of Financial Statements*.

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 IFRSs issued by the IASB. GBEs are defined in IPSAS 1.

Definitions

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

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

   A <u>change in accounting estimate</u> 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.

<u>Impracticable</u> 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.

<u>Prior period errors</u> 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.

<u>Prospective application</u> 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 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.**

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. IPSASs are accompanied by guidance to assist entities in applying their requirements. All such guidance states whether it is an integral part of IPSASs. Guidance that is an integral part of IPSASs is mandatory. Guidance that is not an integral part of IPSASs 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 A 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 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 (a) the most recent pronouncements of other standard-setting bodies, and (b) accepted public or private sector practices, but only to the extent that these do not conflict with the sources in paragraph 14. Examples of such pronouncements include 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 an IPSAS 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 IPSAS 31, *Intangible Assets*, is a change in accounting policy to be dealt with as a revaluation in accordance with IPSAS 17 or IPSAS 31, 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 Standard, 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 14, apply an accounting policy from (a) the most recent pronouncements of other standard-setting bodies, and (b) accepted public or private sector practices, but only to the extent that these are consistent with paragraph 14. Examples of such pronouncements include 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 (a) has an effect on the current period or any prior period, (b) would have such an effect, except that it is impracticable to determine the amount of the adjustment, or (c) 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 (a) has an effect on the current period or any prior period, (b) would have an effect on that period, except that it is impracticable to determine the amount of the adjustment, or (c) 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 47–52).

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 re-create 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 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.**

59A. **Paragraphs 9, 11, and 14 were amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged.**

59B. **Paragraph 60 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial**

statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.

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

Withdrawal of IPSAS 3 (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 IPSASs

IPSAS 2, *Cash Flow Statements*, is amended as follows:

Paragraphs 40 and 41 on extraordinary items are deleted.

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

Direct Method Cash Flow Statement (paragraph 27(a))

Notes to the Cash Flow Statement

…

(c) *Reconciliation of Net Cash Flows from Operating Activities to Surplus/(Deficit)*

(in thousands of currency units)	**20X2**	**20X1**
Surplus/(deficit) ~~from ordinary activities~~	X	X
Non-cash movements		
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)
Net cash flows from operating activities	**X**	**X**

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**
CASH FLOWS FROM OPERATING ACTIVITIES		
Surplus/(deficit)	X	X
Non-cash movements		
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)
Net cash flows from operating activities	**X**	**X**

IPSAS 18, *Segment Reporting*, is amended as described below.

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 the Illustrative Example, the second last paragraph is deleted.

In IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, paragraph 111 is deleted.

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*.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 3.

Revision of IPSAS 3 as a result of the IASB's General Improvements Project

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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. 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 IASs[1] 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),[2] 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 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

[1] 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.

[2] 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 *Comprehensive Subscription Service* can view the Bases for Conclusions on the IASB's website at http://www.iasb.org). In those cases where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

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.

Revision of IPSAS 3 as a result of the IASB's Improvements to IFRSs issued in 2008

BC7. The IPSASB reviewed the revisions to IAS 8 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendments.

Implementation Guidance

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

Retrospective Restatement of Errors

IG1. During 20X2, the entity discovered that revenue from income taxes was incorrect. Income taxes of CU[3]6,500 that should have been recognized in 20X1 were incorrectly omitted from 20X1 and recognized as revenue in 20X2.

IG2. The entity's accounting records for 20X2 show revenue from taxation of CU60,000 (including the CU6,500 taxation that should have been recognized in opening balances), and expenses of CU86,500.

IG3. In 20X1, the entity reported:

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

IG4. 20X1 opening accumulated surplus was CU20,000, and closing accumulated surplus was CU27,000.

IG5. The entity had no other revenue or expenses.

IG6. 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

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

3 In these examples, monetary amounts are denominated in "currency units" (CU).

Public Sector Entity X Statement of Changes in Equity

	Contributed capital	Accumulated Surpluses	Total
	CU	CU	CU
Balance at 31 December 20X0	5,000	20,000	25,000
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

1. 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

Change in Accounting Policy with Retrospective Application

IG7. 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 that 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.

IG8. 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.

IG9. The accounting records for 20X2 show surplus before interest of CU30,000; and interest expense of CU3,000 (which relates only to 20X2).

IG10. The entity has not recognized any depreciation on the power station because it is not yet in use.

IG11. In 20X1, the entity reported:

	CU
Surplus before interest	18,000
Interest expense	–
Surplus	18,000

IG12. 20X1 opening accumulated surpluses was CU20,000 and closing accumulated surpluses was CU38,000.

IG13. 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

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

Public Sector Entity Statement of Changes in Net Assets/Equity

	Contributed capital	(restated) 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
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 Notes to the Financial Statements

1. 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.

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

Prospective Application of a Change in Accounting Policy When Retrospective Application is not Practicable

IG14. During 20X2, the entity changed its accounting policy for depreciating property, plant, and equipment, so as to apply much more fully a components approach, while at the same time adopting the revaluation model.

IG15. 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.

IG16. 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.

IG17. Additional information:

	CU
Property, plant and equipment	
Cost	25,000
Depreciation	(14,000)
Net book value	11,000
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

Extracts from Notes to the Financial Statements

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

Comparison with IAS 8

IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, is drawn primarily from IAS 8 (2003), *Accounting Policies, Changes in Accounting Estimates and Errors* and includes amendments made to IAS 8 as part of the *Improvements to IFRSs* issued in May 2008. 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,” “accumulated surplus or deficit,” and “net assets/equity” in IPSAS 3. The equivalent terms in IAS 8 are “income statement,” “retained earnings,” 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 yet 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 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 Financial Reporting Standards (IFRS) Foundation.

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E-mail: publications@ifrs.org

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IPSAS 4—THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* was issued in May 2000.

In December 2006 the IPSASB issued a revised IPSAS 4.

In April 2008 the IPSASB issued a revised IPSAS 4.

Since then, IPSAS 4 has been amended by the following IPSASs:

- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)

Table of Amended Paragraphs in IPSAS 4

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
3	Amended	IPSAS 37 January 2015 IPSAS 29 January 2010
4	Amended	IPSAS 29 January 2010
5	Amended	IPSAS 29 January 2010
10	Amended	IPSAS 37 January 2015
13	Amended	IPSAS 37 January 2015
21	Amended	IPSAS 37 January 2015
22	Amended	IPSAS 35 January 2015
31	Amended	IPSAS 29 January 2010
38	Amended	IPSAS 37 January 2015

Paragraph Affected	How Affected	Affected By
47	Amended	IPSAS 35 January 2015
50	Amended	IPSAS 37 January 2015
51	Amended	IPSAS 37 January 2015 IPSAS 35 January 2015
53	Amended	IPSAS 35 January 2015
55	Amended	IPSAS 35 January 2015 IPSAS 35 January 2015
57	Amended	IPSAS 37 January 2015
57A	New	IPSAS 37 January 2015
57B	New	IPSAS 37 January 2015
57C	New	IPSAS 37 January 2015
57D	New	IPSAS 37 January 2015
58	Amended	IPSAS 37 January 2015
61	Amended	IPSAS 29 January 2010
67	Deleted	IPSAS 33 January 2015
68	Deleted	IPSAS 33 January 2015
69	Deleted	IPSAS 33 January 2015
70	Deleted	IPSAS 33 January 2015
71A	New	IPSAS 33 January 2015
71B	New	IPSAS 37 January 2015 IPSAS 35 January 2015
72	Amended	IPSAS 33 January 2015

April 2008

IPSAS 4—THE EFFECTS OF CHANGES IN FOREIGN EXCHANGE RATES

CONTENTS

Basis for Conclusions

Table of Concordance

Comparison with IAS 21

International Public Sector Accounting Standard 4, *The Effects of Changes in Foreign Exchange Rates*, is set out in paragraphs 1–73. All the paragraphs have equal authority. IPSAS 4 should be read in the context of its objective, the Basis for Conclusions, the *Preface to the International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. 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 (a) which exchange rate(s) to use, and (b) 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 IPSAS 29, *Financial Instruments: Recognition and Measurement*;**

   (b) **In translating the financial performance and financial position of foreign operations that are included in the financial statements of the entity by consolidation, or by the equity method; and**

   (c) **In translating an entity's financial performance and financial position into a presentation currency.**

4. IPSAS 29 applies 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 IPSAS 29 (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. IPSAS 29 applies to 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 issued by the 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:**

<u>Closing rate</u> is the spot exchange rate at the reporting date.

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

<u>Exchange rate</u> is the ratio of exchange for two currencies.

<u>Foreign currency</u> is a currency other than the functional currency of the entity.

<u>Foreign operation</u> is an entity that is a controlled entity, associate, joint arrangement, 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.

<u>Functional currency</u> is the currency of the primary economic environment in which the entity operates.

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

<u>Net investment in a foreign operation</u> is the amount of the reporting entity's interest in the net assets/equity of that operation.

<u>Presentation currency</u> is the currency in which the financial statements are presented.

<u>Spot exchange rate</u> is the exchange rate for immediate delivery.

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

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 arrangement):

    (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 that 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 that 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 that 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 non-monetary 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 non-monetary 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 stand-alone 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 arrangements. 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 stand-alone entity preparing financial statements or an entity preparing separate financial statements in accordance with IPSAS 34, *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, if those cash flows had 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) **Non-monetary 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) **Non-monetary 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 non-monetary 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 IPSAS 29.

32. **Exchange differences arising (a) on the settlement of monetary items, or (b) 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 non-monetary 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 non-monetary item is recognized in surplus or deficit, any exchange component of that gain or loss shall be recognized in surplus or deficit.**

36. Other IPSASs 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, 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 non-monetary 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 non-monetary 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 or state/provincial 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 that 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, non-controlling interests 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 non-hyperinflationary 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, 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 35, *Consolidated Financial Statements*.)

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 (a) represents a commitment to convert one currency into another, and (b) 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. IPSAS 35 specifies requirements for when the reporting period of the controlling entity is different from that of a controlled entity.

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 35. The same approach is used in applying the equity method to associates and joint ventures in accordance with IPSAS 36, *Investments in Associates and Joint Ventures*.

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 or Partial Disposal of a Foreign Operation

57. **On the disposal of a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation and accumulated in a separate component of net assets/equity shall be reclassified from net assets/equity to surplus or deficit when the gain or loss on disposal is recognized (see IPSAS 1, *Presentation of Financial Statements*).**

57A. In addition to the disposal of an entity's entire interest in a foreign operation, the following partial disposals are accounted for as disposals:

(a) When the partial disposal involves the loss of control of a controlled entity that includes a foreign operation, regardless of whether the entity retains a non-controlling interest in its former controlled entity after the partial disposal; and

(b) When the retained interest after the partial disposal of an interest in a joint arrangement or a partial disposal of an interest in an associate that includes a foreign operation is a financial asset that includes a foreign operation.

57B. On disposal of a controlled entity that includes a foreign operation, the cumulative amount of the exchange differences relating to that foreign operation that have been attributed to the non-controlling interests shall be transferred directly to accumulated surplus/deficit.

57C. On the partial disposal of a controlled entity that includes a foreign operation, the entity shall re-attribute the proportionate share of the cumulative amount of the exchange differences accumulated in a separate category of net assets/equity to the non-controlling interests in that foreign operation. In any other partial disposal of a foreign operation the entity shall transfer to accumulated surplus/deficit only the proportionate share of the cumulative amount of the exchange differences accumulated in net assets/equity.

57D. A partial disposal of an entity's interest in a foreign operation is any reduction in an entity's ownership interest in a foreign operation, except those reductions in paragraph 57A that are accounted for as disposals.

58. An entity may dispose or partially 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 pre-acquisition surplus. A writedown of the carrying amount of a foreign

operation, either because of its own losses or because of an impairment recognized by the entity holding the interest, 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 writedown.

Tax Effects of Exchange Differences

59. For reporting entities subject to income taxes, guidance on the treatment of (a) tax effects associated with the gains and losses on foreign currency transactions, and (b) 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 IPSAS 29; 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 IPSASs 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 IPSASs 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 IPSASs;**

(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. [Deleted]

68. [Deleted]

69. [Deleted]

70. [Deleted]

Effective Date

71. **An entity shall apply this Standard for annual financial statements covering 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.**

71A. **Paragraphs 67, 68, 69, 70 and 72 were amended by IPSAS 33, First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs) issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

71B. **IPSAS 35, *Consolidated Financial Statements* and IPSAS 37, *Joint Arrangements*, issued in January 2015, amended paragraphs 3(b), 10, 13, 21,_22, 38, 47, 50, 51, 53, 55, 57 and 58 and added paragraphs 57A, 57B,**

57C and 57D. An entity shall apply those amendments when it applies IPSAS 35 and IPSAS 37.

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

Withdrawal of IPSAS 4 (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.

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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. The Comparison with IAS 21 references only the version of IAS 21 that was revised in 2003 and amended in 2005.[1]

BC3. In May 2000, the IPSASB's predecessor, the Public Sector Committee (PSC),[2] 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 Subscription Service* can view the Basis for Conclusions on the IASB's website at http://www.iasb.org).

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1 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.

2 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. 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.

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, and 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*, (Revised 1993) 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 Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IPSAS 5—BORROWING COSTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 5, *Borrowing Costs* was issued in May 2000.

Since then, IPSAS 5 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- IPSAS 32, *Service Concession Arrangements: Grantor* (issued October 2011)

Table of Amended Paragraphs in IPSAS 5

Paragraph Affected	How Affected	Affected By
6	Amended	IPSAS 32 October 2011
41	Deleted	IPSAS 33 January 2015
42A	New	IPSAS 32 October 2011
42B	New	IPSAS 33 January 2015
43	Amended	IPSAS 33 January 2015

May 2000

IPSAS 5—BORROWING COSTS

CONTENTS

International Public Sector Accounting Standard 5, *Borrowing Costs*, is set out in the objective and paragraphs 1–43. All the paragraphs have equal authority. IPSAS 5 should be read in the context of its objective, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

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 shall 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 Government Business Enterprises (GBEs) apply IFRSs 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:**

   <u>Borrowing costs</u> are interest and other expenses incurred by an entity in connection with the borrowing of funds.

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

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

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 service concession arrangements; 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 that 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. 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 shall 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 shall disclose the accounting policy adopted for borrowing costs.**

Borrowing Costs—Allowed Alternative Treatment

Recognition

17. **Borrowing costs shall 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 shall be capitalized as part of the cost of that asset. The amount of borrowing costs eligible for capitalization shall 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 (a) it is probable that they will result in future economic benefits or service potential to the entity, and (b) 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 shall 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 coordinated 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 that 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 (a) through the use of loans denominated in or linked to foreign currencies, (b) when the economic entity operates in highly inflationary economies, and (c) 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 shall 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 shall be determined by applying a capitalization rate to the outlays on that asset. The capitalization rate shall 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 shall 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 that 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 IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate. 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 shall 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 shall 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 shall 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 shall 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 (a) an operating theatre in a hospital when all construction must be complete before the theatre may be used, (b) a sewage treatment plant where several processes are carried out in sequence at different parts of the plant, and (c) a bridge forming part of a highway.

Disclosure

40. **The financial statements shall 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 Provision

41. [Deleted]

Effective Date

42. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after July 1, 2001. Earlier application is encouraged. If an entity applies this Standard for a period beginning before July 1, 2001, it shall disclose that fact.**

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

amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 5, 7 and 107C of IPSAS 17, the amendments to paragraphs 2 and 125A of IPSAS 29 and the amendments to paragraphs 6 and 132A of IPSAS 31.

42B. **Paragraphs 41 and 43 were amended by IPSAS 33, First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs) issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

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

Comparison with IAS 23

IPSAS 5, *Borrowing Costs* is drawn primarily from IAS 23, *Borrowing Costs* (1993). 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 "revenue," "statement of financial performance," and "net assets/equity" in IPSAS 5. The equivalent terms in IAS 23 are "income," "income statement," 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 Financial Reporting Standards (IFRS) Foundation.

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IPSAS 6—CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 6, *Consolidated and Separate Financial Statements* was issued in May 2000.

In December 2006 the IPSASB issued a revised IPSAS 6.

Since then, IPSAS 6 has been amended by the following IPSASs:

- *Improvements to IPSASs 2011* (issued October 2011)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)

Table of Amended Paragraphs in IPSAS 6

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
22	Amended	IPSAS 29 January 2010
52	Amended	IPSAS 29 January 2010
58	Amended	IPSAS 29 January 2010
61	Amended	IPSAS 29 January 2010
IG8	Amended	IPSAS 29 January 2010

December 2006

IPSAS 6—CONSOLIDATED AND SEPARATE FINANCIAL STATEMENTS

CONTENTS

International Public Sector Accounting Standard 6, *Consolidated and Separate Financial Statements*, is set out in paragraphs 1–71. All the paragraphs have equal authority. IPSAS 6 should be read in the context of the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the 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:**

   <u>Consolidated financial statements</u> are the financial statements of an economic entity presented as those of a single entity.

   <u>Controlled entity</u> is an entity, including an unincorporated entity such as a partnership, which is under the control of another entity (known as the controlling entity).

   <u>Controlling entity</u> is an entity that has one or more controlled entities.

The <u>cost method</u> 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.

<u>Minority interest</u> 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.

<u>Separate financial statements</u> 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 IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

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 that 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 IPSASs.**

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, while 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. IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures* provide guidance on 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 the *Glossary of Defined Terms*) 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 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 (a) may benefit from the activities of another entity in terms of a distribution of its surpluses (such as a dividend), and (b) 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 (a) share warrants, (b) share call options, (c) debt or equity instruments that are convertible into ordinary shares, or (d) 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. 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 that 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 that 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[1] (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that other entity.

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 cooperate with it in achieving its objectives.

(d) The entity is exposed to the residual liabilities of the other entity.

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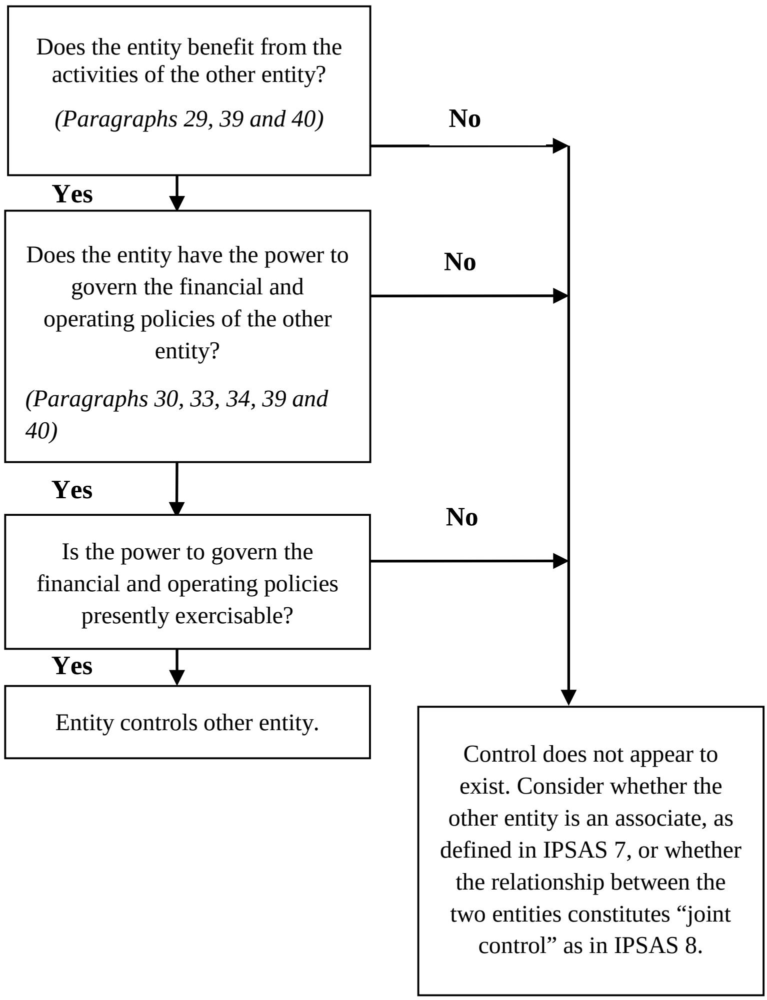
1 Golden share refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associated with the holder's ownership interest or representation on the governing body.

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 (a) revenues from sales and transfers, (b) revenues recognized consequent to an appropriation or other budgetary authority, (c) expenses, and (d) 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 (a) an associate as defined in IPSAS 7, or (b) a jointly controlled entity as defined in IPSAS 8, it shall be accounted for as a financial instrument. IPSAS 29 provides guidance on the recognition and measurement of 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 a financial instrument in accordance with IPSAS 29.**

    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 IPSASs. 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 the recognition and measurement of financial instruments can be found in IPSAS 29.

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 IPSASs 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 IPSASs.**

66. Controlling entities that adopt accrual accounting for the first time in accordance with IPSASs may have many controlled entities, with a 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 fully eliminate balances and transactions between entities within the economic entity.

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 (2006).

Effective Date

69. **An entity shall apply this 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 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 6 (2000)

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

Appendix

Amendments to Other IPSASs

In IPSASs 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*.

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.**

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 6.

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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 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)[1] 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),[2] 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 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 http://www.iasb.org). In those cases

[1] 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.

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

where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

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.

Implementation Guidance

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

Consideration of Potential Voting Rights

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. Control is defined 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 (a) assessing all the factors described in paragraphs 39 and 40 of IPSAS 6 and paragraphs 12 and 13 of IPSAS 7 respectively, and (b) 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 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. IPSAS 29 provides guidance on the recognition and measurement of financial instruments. However, it does not apply to interests in controlled entities, associates, and jointly controlled entities that are (a) consolidated, (b) accounted for using the equity method, (c) 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 IPSAS 29. In all other cases, guidance on accounting for instruments containing potential voting rights can be found in IPSAS 29.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 6, IPSAS 7, and IPSAS 8.

IE1. 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.

Options are Out of the Money

IE2. 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.

IE3. Although 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.

Right to Purchase at Premium to Fair Value

IE4 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.

IE5. 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.

Possibility of Exercise or Conversion

IE6. 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.

Possibility of Exercise of Rights

IE7. 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.

IE8. 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.

Other Rights that have the Potential to Increase an Entity's Voting Power or Reduce Another Entity's Voting Power—Example A

IE9. 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).

IE10. 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.

Other Rights that have the Potential to Increase an Entity's Voting Power or Reduce Another Entity's Voting Power—Example B

IE11. 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.

IE12. 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.

Management Intention—Example A

IE13. 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.

Management Intention—Example B

IE14. The cities of Tolosa, Lutetia, and Massilia each own 33⅓ 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 rights 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.

Financial Ability—Example A

IE15. 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.

IE16. 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.

Financial Ability—Example B

IE17. 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.

IE18. 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.

Comparison with IAS 27

IPSAS 6, *Consolidated and Separate Financial Statements* is drawn primarily from 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 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,” “net assets/equity,” “economic entity,” “controlling entity,” and “controlled entity” in IPSAS 6. The equivalent terms in IAS 27 are “income statement,” “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 additional illustrative examples that reflect the public sector context.

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 the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 7—INVESTMENTS IN ASSOCIATES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 7, *Investments in Associates* was issued in May 2000.

In December 2006 the IPSASB issued a revised IPSAS 7.

Since then, IPSAS 7 has been amended by the following IPSASs:

- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 7

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
1	Amended	IPSAS 29 January 2010 Improvements to IPSASs January 2010
2	Amended	IPSAS 29 January 2010
12	Amended	Improvements to IPSASs November 2010
20	Amended	IPSAS 29 January 2010
21	Amended	IPSAS 29 January 2010
24	Amended	IPSAS 29 January 2010
25	Amended	IPSAS 29 January 2010
37	Amended	IPSAS 29 January 2010
38	Amended	IPSAS 29 January 2010
39	Amended	IPSAS 29 January 2010
47A	New	Improvements to IPSASs January 2010

December 2006

IPSAS 7—INVESTMENTS IN ASSOCIATES

CONTENTS

International Public Sector Accounting Standard 7, *Investments in Associates*, is set out in paragraphs 1–49. All the paragraphs have equal authority. IPSAS 7 should be read in the context of the Basis for Conclusions, the *Preface to the International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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 IPSAS 29, *Financial Instruments: Recognition and Measurement*. An entity holding such an investment shall make the disclosures required by paragraph 43(f).

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 IPSAS 29.

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. This 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. While such contributions are non-exchange in nature, they allow the public sector entity to participate in the operation of the hospital, and the charity is accountable to the public sector entity for its use of public monies. However, the contributions made by the public sector entity do not constitute an ownership interest, as the charity could seek alternative funding and thereby prevent the public sector entity from participating in the operation of the hospital. Accordingly, the public sector entity is not exposed to the risks, nor does it enjoy the rewards, that are incidental to an ownership interest.

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 IFRSs issued by the 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.

   The equity method (for the purpose of this Standard) 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.

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

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 (a) consolidated financial statements, (b) financial statements in which investments are accounted for using the equity method, and (c) 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 (a) paragraph 16 of IPSAS 6, *Consolidated and Separate Financial Statements*, from consolidation, (b) paragraph 3 of IPSAS 8, *Interests in Joint Ventures*, from applying proportionate consolidation, or (c) 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 in the form of a shareholding or other formal equity structure.

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 similar 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 (a) share warrants, (b) share call options, (c) debt or equity instruments that are convertible into ordinary shares, or (d) 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, and 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 IPSASs.**

20. **Investments described in paragraph 19(a) shall be classified as held for trading and accounted for in accordance with IPSAS 29.**

21. When an investment in an associate previously accounted for in accordance with IPSAS 29 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 (a) the sale is in process at the reporting date, and (b) 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 IPSAS 29 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 IPSAS 29.**

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 IPSAS 29 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 IPSAS 29 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 IPSAS 29 indicates that the investment may be impaired, an entity applies IPSAS 21, *Impairment of Non-Cash-Generating Assets*, and IPSAS 26, *Impairment of Cash-Generating Assets*. IPSAS 26 directs an entity to determine the value in use of the cash-generating investment. Based on IPSAS 26, 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 IPSAS 26.

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 IPSAS 1.**

46. **In accordance with IPSAS 19, *Provisions, Contingent Liabilities 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 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.**

47A. **Paragraph 1 was amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2011. If an entity applies the amendment for a period beginning before January 1, 2011, it shall disclose that fact and apply for that earlier period paragraph 3 of IPSAS 28, *Financial Instruments: Presentation*, paragraph 1 of IPSAS 8, and paragraph 3 of IPSAS 30, *Financial Instruments: Disclosures*. An entity is encouraged to apply the amendments prospectively.**

48. 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 7 (2000)

49. This Standard supersedes IPSAS 7, *Accounting for Investments in Associates*, issued in 2000.

Appendix

Amendments to Other IPSASs

In IPSASs applicable at January 1, 2008, 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, IPSAS 7.

Revision of IPSAS 7 as a result of the IASB's General Improvements Project 2003

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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 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 IASs[1] 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),[2] 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 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 http://www.iasb.org). In those cases

[1] 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.

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

where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

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.

Revision of IPSAS 7 as a result of the IASB's Improvements to IFRSs issued in 2008

BC7. The IPSASB reviewed the revisions to IAS 28 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendment.

Comparison with IAS 28

IPSAS 7, *Investments in Associates* is drawn primarily from IAS 28, *Investments in Associates* and includes an amendment made to IAS 28 as part of the *Improvements to IFRSs* issued in May 2008. 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," and "net assets/equity" in IPSAS 7. The equivalent terms in IAS 28 are "income statement," and "equity."
- IPSAS 7 does not use the term "income," which in IAS 28 has a broader meaning than the term "revenue."

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 the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IPSAS 8—INTERESTS IN JOINT VENTURES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 8, *Interests in Joint Ventures* was issued in May 2000.

In December 2006 the IPSASB issued a revised IPSAS 8.

Since then, IPSAS 8 has been amended by the following IPSASs:

- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)

Table of Amended Paragraphs in IPSAS 8

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
1	Amended	IPSAS 29 January 2010 Improvements to IPSASs January 2010
2	Amended	IPSAS 29 January 2010
47	Amended	IPSAS 29 January 2010
48	Amended	IPSAS 29 January 2010
58	Amended	IPSAS 29 January 2010
69A	New	Improvements to IPSASs January 2010

December 2006

IPSAS 8—INTERESTS IN JOINT VENTURES

CONTENTS

International Public Sector Accounting Standard 8, *Interests in Joint Ventures*, is set out in paragraphs 1–71. All the paragraphs have equal authority. IPSAS 8 should be read in the context of the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

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 IPSAS 29, *Financial Instruments: Recognition and Measurement*. A venturer holding such an interest shall make the disclosures required by paragraphs 62 and 63.

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 IPSAS 29.

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 (if they are) 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 neither filed, 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 IPSASs.**

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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the 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:**

The <u>equity method</u> (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.

<u>Joint control</u> is the agreed sharing of control over an activity by a binding arrangement.

<u>Joint venture</u> is a binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.

<u>Proportionate consolidation</u> 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.

<u>Significant influence</u> (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.

<u>Venturer</u> is a party to a joint venture and has joint control over that joint venture.

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

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 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. A 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:

   - The activity, duration and reporting obligations of the joint venture;
   - The appointment of the board of directors or equivalent governing body of the joint venture and the voting rights of the venturers;
   - Capital contributions by the venturers; and
   - 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 (a) those decisions in areas essential to the goals of the joint venture that require the consent of all the

venturers, and (b) those decisions that 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 (a) is in legal reorganization or in bankruptcy, (b) is subject to an administrative restructuring of government arrangements, or (c) 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. Neither (a) financial statements in which proportionate consolidation or the equity method is applied, nor (b) financial statements of an entity that does not have a controlled entity, associate or venturer's interest in a jointly controlled entity are separate financial statements.

15. Separate financial statements are (a) those presented in addition to consolidated financial statements, (b) financial statements in which investments are accounted for using the equity method, and (c) 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 (a) paragraph 16 of IPSAS 6 from consolidation, (b) paragraph 19(c) of IPSAS 7 from applying the equity method, or (c) 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 finances, 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 of, 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; and

(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 to 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 IPSASs, 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 (a) whether it also has investments in controlled entities, or (b) 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 (a) any assets or liabilities by the deduction of other

liabilities or assets, or (b) 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 (a) by those who argue that it is inappropriate to combine controlled items with jointly controlled items, and (b) 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 as held for trading and accounted for in accordance with IPSAS 29.

48. Guidance on the recognition and measurement of financial instruments dealt with in paragraph 47 can be found in IPSAS 29.

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 (a) the sale is in process at the reporting date, and (b) 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*, or IPSAS 26, *Impairment of Cash-Generating Assets,* as appropriate. 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 IPSAS 29.

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 IPSASs.

66. Entities that adopt accrual accounting for the first time in accordance with IPSASs 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 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.**

69A. **Paragraph 1 was amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2011. If an entity applies the amendment for a period beginning before January 1, 2011, it shall disclose that fact and apply for that earlier period paragraph 3 of IPSAS 28, *Financial Instruments: Presentation*, paragraph 1 of IPSAS 7, and paragraph 3 of IPSAS 30, *Financial Instruments: Disclosures*. An entity is encouraged to apply the amendments prospectively.**

70. 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 8 (2000)

71. This Standard supersedes IPSAS 8, *Financial Reporting of Interests in Joint Ventures*, issued in 2000.

Appendix

Amendments to Other IPSASs

In IPSASs applicable at January 1, 2008, references to the former 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, IPSAS 8.

Revision of IPSAS 8 as a result of the IASB's General Improvements Project 2003

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the IPSASB's work program. The IPSASB 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 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) [1] 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),[2] 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 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 http://www.iasb.org). In those cases

[1] 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.

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

where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

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.

Revision of IPSAS 8 as a result of the IASB's Improvements to IFRSs issued in 2008

BC7. The IPSASB reviewed the revisions to IAS 31 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendment.

Comparison with IAS 31

IPSAS 8, *Interests in Joint Ventures* is drawn primarily from IAS 31, *Interests in Joint Ventures* and includes an amendment made to IAS 31 as part of the *Improvements to IFRSs* issued in May 2008. 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," and "net assets/equity" in IPSAS 8. The equivalent terms in IAS 31 are "income statement," 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 that 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 IPSASs. 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 the International Financial Reporting Standards (IFRS) Foundation.

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

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Internet: www.ifrs.org

IPSAS 9—REVENUE FROM EXCHANGE TRANSACTIONS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 9, *Revenue from Exchange Transactions* was issued in July 2001.

Since then, IPSAS 9 has been amended by the following IPSASs:

- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- IPSAS 27, *Agriculture* (issued December 2009)
- IPSAS 29, Financial Instruments: Recognition and Measurement (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 9

Paragraph Affected	How Affected	Affected By
1	Amended	Improvements to IPSASs November 2010
9	Amended	IPSAS 37 January 2015 Improvements to IPSASs November 2010
10	Amended	IPSAS 27 December 2009 IPSAS 29 January 2010 Improvements to IPSASs November 2010
12	Amended	Improvements to IPSASs November 2010
33	Amended	Improvements to IPSASs November 2010
34	Amended	Improvements to IPSASs November 2010
36	Amended	Improvements to IPSASs November 2010

Paragraph Affected	How Affected	Affected By
39	Amended	Improvements to IPSASs November 2010
41A	New	IPSAS 33 January 2015
42B	New	IPSAS 37 January 2015
42	Amended	IPSAS 33 January 2015
IG1	Amended	Improvements to IPSASs November 2010
IG12	Amended	IPSAS 29 January 2010
Heading above IG29	Amended	Improvements to IPSASs November 2010
IG32	New	Improvements to IPSASs November 2010
IG33	New	Improvements to IPSASs November 2010
IG34	New	Improvements to IPSASs November 2010

July 2001

IPSAS 9—REVENUE FROM EXCHANGE TRANSACTIONS

CONTENTS

International Public Sector Accounting Standard 9, *Revenue from Exchange Transactions*, is set out in the objective and paragraphs 1–42. All the paragraphs have equal authority. IPSAS 9 should be read in the context of its objective, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

The IASB's *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 IASB 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 (a) future economic benefits or service potential will flow to the entity, and (b) 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 that prepares and presents financial statements under the accrual basis of accounting shall 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 or similar distributions.**

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 Government Business Enterprises (GBEs) apply IFRSs issued by the 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 IPSAS 11, *Construction Contracts*.

8. Goods includes (a) goods produced by the entity for the purpose of sale, such as publications, and (b) 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 similar distributions – 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 arising from:

(a) Lease agreements (see IPSAS 13, *Leases*);

(b) Dividends or similar distributions arising from investments that are accounted for under the equity method (see IPSAS 36, *Investments in Associates and Joint Ventures*);

(c) Gains from the sale of property, plant, and equipment (which are dealt with in IPSAS 17, *Property, Plant, and Equipment*);

(d) Insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts;

(e) Changes in the fair value of financial assets and financial liabilities or their disposal (guidance on the recognition and measurement of financial instruments can be found in IPSAS 29, *Financial Instruments: Recognition and Measurement*);

(f) Changes in the value of other current assets;

(g) Initial recognition, and from changes in the fair value of biological assets related to agricultural activity (see IPSAS 27, *Agriculture*);

(g) Initial recognition of agricultural produce (see IPSAS 27); and

(h) The extraction of mineral ores.

Definitions

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

<u>Exchange transactions</u> 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.

<u>Fair value</u> is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

<u>Non-exchange transactions</u> 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 IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

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 an 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 that flow to the entity, and do not result in increases in assets or decreases in liabilities. Therefore, they are excluded from revenue. Similarly, in an agency relationship, the gross inflows of economic benefits or service potential include amounts collected on behalf of the principal that 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 (a) result in an equal change in both assets, and liabilities and (b) 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 shall 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 that are of a similar nature and value, the exchange is not regarded as a transaction that 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 that 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 shall 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 shall 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 (a) the outcome of a transaction cannot be estimated reliably, and (b) 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 shall 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 that 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 or Similar Distributions

33. **Revenue arising from the use by others of entity assets yielding interest, royalties, and dividends or similar distributions shall 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 shall be recognized using the following accounting treatments:**

    (a) **Interest shall be recognized on a time proportion basis that takes into account the effective yield on the asset;**

    (b) **Royalties shall be recognized as they are earned in accordance with the substance of the relevant agreement; and**

    (c) **Dividends or similar distributions shall 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 or similar distributions on equity securities are declared from pre-acquisition net surplus, those dividends or similar distributions are deducted from the cost of the securities. If it is difficult to make such an allocation except on an arbitrary basis; dividends or similar distributions 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 shall disclose:**

(a) **The accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;**

(b) **The amount of each 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 similar distributions; 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 IPSAS 19, *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. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after July 1, 2002. Earlier application is encouraged. If an entity applies this Standard for a period beginning before July 1, 2002, it shall disclose that fact.**

41A. **Paragraph 42 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies**

IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.

41B. **IPSAS 37, *Joint Arrangements*, issued in January 2015, amended paragraph 10(b). An entity shall apply that amendment when it applies IPSAS 37.**

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

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 9.

IG1. 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 or similar distributions.

IG2. 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 implementation guidance 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

Housing

IG3. Rental income from the provision of housing is recognized as the income is earned in accordance with the terms of the tenancy agreement.

School Transport

IG4. Revenue from fares charged to passengers for the provision of school transport is recognized as the transport is provided.

Management of Toll Roads

IG5. Revenue from the management of toll roads is recognized as it is earned, based on the usage of the roads.

Processing of Court Cases

IG6. 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.

Management of Facilities, Assets, or Services

IG7. Revenue from the management of facilities, assets, or services is recognized over the term of the contract as the management services are provided.

Science and Technology Research

IG8. Revenue received from clients from contracts for undertaking science and technology research is recognized by reference to the stage of completion on individual projects.

Installation Fees

IG9. 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.

Servicing Fees Included in the Price of the Product

IG10. 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.

Insurance Agency Commissions

IG11. Insurance agency commissions received or receivable that 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.

Financial Service Fees

IG12. The recognition of revenue for financial service fees depends on (a) the purposes for which the fees are assessed, and (b) 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 that are an integral part of the effective yield of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

(a) **Fees that are an integral part of the effective interest rate of a financial instrument**

Such fees are generally treated as an adjustment to the effective interest rate. However, when the financial instrument is measured at fair value with the change in fair value recognized in surplus or deficit, the fees are recognized as revenue when the instrument is initially recognized.

(i) *Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IPSAS 29 is classified as a financial asset "at fair value through surplus or deficit"*

Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs (as defined in IPSAS 29), are deferred and recognized as an adjustment to the effective interest rate.

(ii) *Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IPSAS 29*

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IPSAS 29, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition of a financial instrument and, together with the related transaction costs (as defined in IPSAS 29), is deferred and recognized as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognized as revenue on expiry. Loan commitments that are within the scope of IPSAS 29 are accounted for as derivatives and measured at fair value.

(iii) *Origination fees received on issuing financial liabilities measured at amortized cost*

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as "at fair value through surplus or deficit," the origination fees received are included, with the related transaction costs (as defined in IPSAS 29) incurred, in the initial carrying amount of the financial liability and recognized as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

(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.

(ii) *Commitment fees to originate a loan when the loan commitment is outside the scope of IPSAS 29*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IPSAS 29, the commitment fee is recognized as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IPSAS 29 are accounted for as derivatives and measured at fair value.

(iii) *Investment management fees*

Fees charged for managing investments are recognized as revenue as the services are provided.

Incremental costs that are directly attributable to securing an investment management contract are recognized as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in IPSAS 29, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity’s contractual right to benefit from providing investment management services, and is amortized as the entity recognizes the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

Some financial services contracts involve both the origination of one or more financial instruments and the provision of investment management services. An example is a long-term monthly saving contract linked to the management of a pool of equity securities. The provider of the contract distinguishes the transaction costs relating to the origination of the financial instrument from the costs of securing the right to provide investment management services.

(c) **Fees that are earned on the execution of a significant act**

The fees are recognized as revenue when the significant act has been completed, as in the examples below.

(i) *Commission on the allotment of shares to a client*

The commission is recognized as revenue when the shares have been allotted.

(ii) *Placement fees for arranging a loan between a borrower and an investor*

The fee is recognized as revenue when the loan has been arranged.

(iii) *Loan syndication fees*

A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognized as revenue when the syndication has been completed.

Admission Fees

IG13. 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 that reflects the extent to which services are performed at each event.

Tuition Fees

IG14. Revenue is recognized over the period of instruction.

Initiation, Entrance, and Membership Fees

IG15. 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.

Franchise or Concession Fees

IG16. 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 that, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no return. Such transactions do not give rise to revenue.

Fees from the Development of Customized Software

IG17. 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

"Bill and Hold" Sales, in Which Delivery is Delayed at the Purchaser's Request but the Purchaser Takes Title and Accepts Billing

IG18. 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.

IG19. *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.

Layaway Sales under Which the Goods are Delivered only when the Purchaser Makes the Final Payment in a Series of Installments

IG20. 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.

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

IG21. Revenue is recognized when the goods are delivered to the purchaser.

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

IG22. 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.

Sales to Intermediate Parties, Such as Distributors, Dealers, or Others for Resale

IG23. 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.

Subscriptions to Publications and Similar Items

IG24. 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.

Installment Sales, under Which the Consideration is Receivable in Installments

IG25. 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.

Real Estate Sales

IG26. 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.

IG27. 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 (a) sale and repurchase agreements that include put and call options, and (b) 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.

IG28. 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 or Similar Distributions

License Fees and Royalties

IG29. 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.

IG30. An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancelable contract that (a) permits the licensee to exploit those rights freely and (b) 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.

IG31. 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.

Recognition and Measurement

Determining whether an entity is acting as a principal or as an agent (2010 amendment)

IG32. Paragraph 12 states that "in an 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." Determining whether an entity is acting as a principal or as an agent requires judgement and consideration of all relevant facts and circumstances.

IG33. An entity is acting as a principal when it has exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. Features that indicate that an entity is acting as a principal include:

- (a) The entity has the primary responsibility for providing the goods or services to the customer or for fulfilling the order, for example by being responsible for the acceptability of the products or services ordered or purchased by the customer;
- (b) The entity has inventory risk before or after the customer order, during shipping or on return;
- (c) The entity has latitude in establishing prices, either directly or indirectly, for example by providing additional goods or services; and
- (d) The entity bears the customer's credit risk for the amount receivable from the customer.

IG34. An entity is acting as an agent when it does not have exposure to the significant risks and rewards associated with the sale of goods or the rendering of services. One feature indicating that an entity is acting as an agent is that the amount the entity earns is predetermined, being either a fixed fee per transaction or a stated percentage of the amount billed to the customer.

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.
- 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 example is the use of the term "net assets/equity" in IPSAS 9. The equivalent term in IAS 18 is "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 Financial Reporting Standards (IFRS) Foundation.

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IPSAS 10—FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 10, *Financial Reporting in Hyperinflationary Economies* was issued in July 2001.

Since then, IPSAS 10 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* (issued December 2006)
- *Improvements to IPSASs* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 10

Paragraph Affected	How Affected	Affected By
Heading above 1	New	Improvements to IPSASs October 2011
1	New	Improvements to IPSASs October 2011
1A	Amended – Existing paragraph 1 renumbered to 1A	Improvements to IPSASs October 2011
1	Amended	IPSAS 4 December 2006
11	Amended	IPSAS 4 December 2006
17	Amended	Improvements to IPSASs January 2010
18	Amended	Improvements to IPSASs January 2010
20	Amended	IPSAS 4 December 2006
22	Amended	Improvements to IPSASs January 2010

Paragraph Affected	How Affected	Affected By
26[1]	Deleted	IPSAS 4 December 2006
28	Amended	Improvements to IPSASs November 2010
29	Amended	Improvements to IPSASs November 2010
33	Amended	IPSAS 4 December 2006
36	Amended	IPSAS 4 December 2006
38A	New	Improvements to IPSASs January 2010
38B	New	Improvements to IPSASs October 2011
38C	New	IPSAS 33 January 2015
39	Amended	IPSAS 33 January 2015

1 Subsequent paragraphs have been renumbered.

July 2001

IPSAS 10—FINANCIAL REPORTING IN HYPERINFLATIONARY ECONOMIES

CONTENTS

International Public Sector Accounting Standard 10, *Financial Reporting in Hyperinflationary Economies*, is set out in paragraphs 1–39. All the paragraphs have equal authority. IPSAS 10 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies*, *Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance

Objective

1. The objective of this Standard is to prescribe the accounting treatment in the consolidated and individual financial statements of an entity whose functional currency is the currency of a hyperinflationary economy. The Standard also specifies the accounting treatment where the economy ceases to be hyperinflationary.

Scope

1A. **An entity that 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. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

4. 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.

5. 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%.

6. 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.

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.

Non-monetary items are items that are not monetary items.

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

The 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 IPSAS 1, 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 shall 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 fair 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. For example, property, plant and equipment, 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 apples 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. For example, restated amounts of property, plant and equipment, goodwill, patents and trademarks are reduced to recoverable amount or recoverable service amount where appropriate, and restated amounts of inventories are reduced to net realizable value or current replacement cost. 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 surplus or deficit. 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.

Gain or Loss 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 gain or loss on the net monetary position may be derived as the difference resulting from the restatement of non-monetary assets, accumulated gains or losses and items in the statement of financial performance and the adjustment of index linked assets and liabilities. The gain or loss 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 gain or loss 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 gain or loss 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 gain or loss 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 shall 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. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after July 1, 2002. Earlier application is encouraged. If an entity applies this Standard for a period beginning before July 1, 2002, it shall disclose that fact.**

38A. **Paragraphs 17, 18, and 22 were amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged.**

38B. **Existing paragraph 1 was renumbered to 1A and a new paragraph 1 was inserted by *Improvements to IPSASs 2011* issued in October 2011. An entity shall apply this amendment for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2013, it shall disclose that fact.**

38C. **Paragraph 39 was amended by IPSAS 33, First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs) issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.**

39. When an entity adopts the accrual basis IPSASs of accounting as defined in IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* for financial reporting purposes subsequent

to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption of IPSASs.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 10.

Revision of IPSAS 10 as a result of the IASB's Improvements to IFRSs issued in 2008

BC1. The IPSASB reviewed the revisions to IAS 29 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendments.

Illustrative Example

This example accompanies, but is not part of, IPSAS 10.

IE1. This 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.

IE2. The following example illustrates the process for restatement of financial statements. In preparing this illustration:

- The gain on net monetary position for the period was indirectly derived as the difference resulting from the restatement of non-monetary assets and liabilities, accumulated gains or losses, and items in the statement of financial performance (see paragraph 28).
- 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 (Un-adjusted)**	**Indexation Factor**	**31.12.X0 (Per IPSAS 12)**		**Gain/Loss on Net Monetary Position**
Cash and investments	5,000	10,000	–	10,000		–
Inventories	–	2,000	180/170	2,118	*Restated*	118
Physical assets:						
Historical cost	47,500	40,000	180/120	60,000		20,000
Accum. depreciation	(22,500)	(20,000)	180/120	(30,000)		(10,000)
Net book value	25,000	20,000	180/120	30,000	*Restated*	10,000
Total Assets	**30,000**	**32,000**		**42,118**		
Borrowings	**26,000**	**26,000**	**–**	**26,000**		
Net Assets						
Brought forward	**4,000**	**4,000**	180/120	6,000	*Restated*	(2,000)
Net surplus for period (see below)		2,000	See below	10,118		1,100
	4,000	**6,000**		**16,118**		**9,218**
Statement of Financial Performance						
Revenues		50,000	180/150	60,000	*Restated*	10,000
Depreciation		(5,000)	180/120	(7,500)	*Restated*	(2,500)
Other expenses		(43,000)	180/150	(51,600)	*Restated*	(8,600)
Gain on net monetary position				9,218		
Surplus for the year		**2,000**		**10,118**		**(1,100)**

NB: This Standard (paragraph 27) 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 gain 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 28).

Comparison with IAS 29

IPSAS 10, *Financial Reporting in Hyperinflationary Economies* is drawn primarily from IAS 29, *Financial Reporting in Hyperinflationary Economies* and includes amendments made to IAS 29 as part of the *Improvements to IFRSs* issued in May 2008. 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 "revenue," "statement of financial performance," and "net assets/equity" in IPSAS 10. The equivalent terms in IAS 29 are "income," "income statement," 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 illustrated example that 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 Financial Reporting Standards (IFRS) Foundation.

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Internet: www.ifrs.org

IPSAS 11—CONSTRUCTION CONTRACTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 11, *Construction Contracts* was issued in July 2001.

Since then, IPSAS 11 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)

Table of Amended Paragraphs in IPSAS 11

Paragraph Affected	How Affected	Affected By
57A	New	IPSAS 33 January 2015
58	Amended	IPSAS 33 January 2015

July 2001

IPSAS 11—CONSTRUCTION CONTRACTS

CONTENTS

International Public Sector Accounting Standard 11, *Construction Contracts*, is set out in the objective and paragraphs 1–58. All the paragraphs have equal authority. IPSAS 11 should be read in the context of its objective, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

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 (a) allocation of construction costs to the reporting period in which the construction work is performed, and (b) 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 noncommercial 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 that prepares and presents financial statements under the accrual basis of accounting shall 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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the 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 IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

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 that 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 that 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 that, 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 agreed constructor's construction costs 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 noncommercial 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 (a) by way of a general appropriation or other allocation of general government funds to the contractor, or (b) 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 shall be treated as a separate construction contract when:**

    (a) **Separate proposals have been submitted for each asset;**

    (b) **Each asset has been subject to separate negotiation, and the contractor and customer 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, shall be treated as a single construction contract when:**

    (a) **The group of contracts is negotiated as a single package;**

    (b) **The contracts are so closely interrelated that they are, in effect, part of a single project with an overall 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 shall 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 shall 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 that 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 (see paragraph 25). Funding agencies may include national and international aid agencies and multilateral and bilateral development banks.

Contract Costs

23. **Contract costs shall 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 that meet the definition of, and recognition criteria for, revenue should be accounted for by the contractor in the same way as other contract revenue (see 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 (a) are systematic and rational, and (b) 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 that 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 shall 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 shall 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 that 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 that 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 that 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 especially 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 shall be recognized only to the extent of contract costs incurred that it is probable will be recoverable; and**

(b) **Contract costs shall 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 shall 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 that 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) That 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 shall 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 shall be recognized as an expense immediately.**

45. Public sector entities may enter into construction contracts that 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 that are largely dependent 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 that 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 shall 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 shall 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 that 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 shall 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) exceed 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. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after July 1, 2002. Earlier application is encouraged. If an entity applies this Standard for a period beginning before July 1, 2002, it shall disclose that fact.**

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

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

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 11.

Disclosure of Accounting Policies

IG1. The following are examples of accounting policy disclosures for a department that enters noncommercial 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 GBEs, and to enter full cost recovery construction contracts with certain state hospitals and state universities.

Noncommercial Contracts

IG2. 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.

IG3. 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

IG4. 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.

IG5. 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

IG6. The following examples deal with a noncommercial 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 30–43 of this Standard).

Noncommercial Contracts

IG7. 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.

IG8. 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.

IG9. 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.

IG10. 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.

IG11. 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.

IG12. A summary of the financial data during the construction period is as follows:

	Year 1	**Year 2**	**Year 3**
Initial amount of revenue agreed in contract	4,000	4,000	4,000
Variation	–	100	100
Total Contract Revenue	4,000	4,100	4,100
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	–
Total estimated contract costs	8,050	8,200	8,200
Stage of completion	26%	74%	100%

IG13. 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.

IG14. The amounts of contract revenue and expenses recognized in the statement of financial performance in the three years are as follows:

	To Date	**Recognized in prior years**	**Recognized in current year**
Year 1			
Revenue (4,000 × .26)	1,040		1,040
Expenses (8,050 × .26)	2,093		2,093
Year 2			
Revenue (4,100 × .74)	3,034	1,040	1,994
Expenses (8,200 × .74)	6,068	2,093	3,975
Year 3			
Revenue (4,100 × 1.00)	4,100	3,034	1,066
Expenses (8,200 × 1.00)	8,200	6,068	2,132

Commercial Contracts

IG15. 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.

IG16. 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.

IG17. By the end of Year 1, the Department's estimate of contract costs has increased to 8,050.

IG18. 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.

IG19. 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:

	Year 1	**Year 2**	**Year 3**
Initial amount of revenue agreed in contract	9,000	9,000	9,000
Variation	–	200	200
Total Contract Revenue	9,000	9,200	9,200
Contract costs incurred to date	2,093	6,168	8,200
Contract costs to complete	5,957	2,032	–
Total estimated contract costs	8,050	8,200	8,200
Estimated surplus	950	1,000	1,000
Stage of completion	26%	74%	100%

IG20. 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.

IG21. 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**
Year 1			
Revenue (9,000 × .26)	2,340		2,340
Expenses (8,050 × .26)	2,093		2,093
Surplus	247		247
Year 2			
Revenue (9,200 × .74)	6,808	2,340	4,468
Expenses (8,200 × .74)	6,068	2,093	3,975
Surplus	740	247	493
Year 3			
Revenue (9,200 × 1.00)	9,200	6,808	2,392
Expenses (8,200 × 1.00)	8,200	6,068	2,132
Surplus	1,000	740	260

Contract Disclosures

Appropriation/Aid Funded Contracts and Full Cost Recovery Contracts

IG22. 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 GBEs and on a full cost recovery basis for state hospitals and state run universities.

IG23. 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.)
- 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.)

IG24. The status of the three contracts in progress at the end of Year 1 is as follows:

	Contract			
	A	**B**	**C**	**Total**
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

IG25. 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

IG26. 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.

IG27. The status of its five contracts in progress at the end of Year 1 is as follows:

	Contract					
	A	**B**	**C**	**D**	**E**	**Total**
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)

The amounts to be disclosed in accordance with paragraphs 51(a), 53(a), and 53(b) are calculated as follows:

	A	**B**	**C**	**D**	**E**	**Total**
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)

IG28. 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 "revenue," and "statement of financial performance" in IPSAS 11. The equivalent terms in IAS 11 are "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 noncommercial 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 noncommercial 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 Financial Reporting Standards (IFRS) Foundation.

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E-mail: publications@ifrs.org

Internet: www.ifrs.org

IPSAS 12—INVENTORIES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 12*, Inventories* was issued in July 2001.

In December 2006 the IPSASB issued a revised IPSAS 12.

Since then, IPSAS 12 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- IPSAS 27*, Agriculture* (issued December 2009)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 12

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
2	Amended	IPSAS 27 December 2009 IPSAS 29 January 2010
15	Amended	Improvements to IPSASs November 2010
29	Amended	IPSAS 27 December 2009
33	Amended	Improvements to IPSASs November 2010
51A	New	IPSAS 27 December 2009
51B	New	IPSAS 33 January 2015
52	Amended	IPSAS 33 January 2015

IPSAS 12—INVENTORIES

CONTENTS

International Public Sector Accounting Standard 12, *Inventories*, is set out in paragraphs 1–53. All the paragraphs have equal authority. IPSAS 12 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for 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 IPSAS 11, *Construction Contracts*);**

   (b) **Financial instruments (see IPSAS 28, *Financial Instruments: Presentation* and IPSAS 29, *Financial Instruments: Recognition and Measurement*);**

   (c) **Biological assets related to agricultural activity and agricultural produce at the point of harvest (see IPSAS 27, *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; and**

   (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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

6. The inventories referred to in paragraph 2(d) are not encompassed by 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, (a) when agricultural crops have been harvested or minerals have been extracted and sale is assured under a forward contract or a government guarantee, or (b) when an active market exists and there is a negligible risk of failure to sell. These inventories are excluded only from 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 only from the measurement requirements of this Standard.

Definitions

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

<u>Current replacement cost</u> is the cost the entity would incur to acquire the asset on the reporting date.

<u>Inventories</u> 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.**

<u>Net realizable value</u> 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.

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

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 (a) materials and supplies awaiting use in the production process, and (b) 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 or paragraph 17 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 (a) the purchase price, (b) import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and (c) 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 (a) the volume of production, such as depreciation and maintenance of factory buildings and equipment, and (b) 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 IPSAS 27, inventories comprising agricultural produce that an entity has harvested from its biological assets shall be measured on initial recognition at their fair value less costs to sell 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 that 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 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 the 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 (a) those costs previously included in the measurement of inventory that has now been sold, exchanged, or distributed, and (b) 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 (a) raw materials and consumables, (b) labor costs, and (c) other costs, together with the amount of the net change in inventories for the period.

Effective Date

51. **An entity shall apply this 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.**

51A. **IPSAS 27 amended paragraph 29. An entity shall apply that amendment for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies IPSAS 27 for a period beginning before April 1, 2011, the amendment shall also be applied for that earlier period.**

51B. **Paragraph 52 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.**

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

Withdrawal 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, IPSAS 12.

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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[1] 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),[2] 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 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 http://www.iasb.org). In those cases where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

1 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.

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

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, *Inventories* (revised 2003). The main differences between IPSAS 12 and IAS 2 are as follows:

- 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 that 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 Financial Reporting Standards (IFRS) Foundation.

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IPSAS 13—LEASES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 13, *Leases* was issued in December 2001.

In December 2006 the IPSASB issued a revised IPSAS 13.

Since then, IPSAS 13 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- IPSAS 32, *Service Concession Arrangements: Grantor* (issued October 2011)
- *Improvements to IPSASs 2011* (issued October 2011)
- IPSAS 27, *Agriculture* (issued December 2009)
- IPSAS 31, *Intangible Assets* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 13

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
2	Amended	IPSAS 27 December 2009
19	Deleted	Improvements to IPSASs November 2010
20	Deleted	Improvements to IPSASs November 2010
20A	New	Improvements to IPSASs November 2010
25	Amended	IPSAS 32 October 2011
26	Amended	IPSAS 32 October 2011
27	Amended	IPSAS 32 October 2011
36	Amended	IPSAS 31 January 2010

Paragraph Affected	How Affected	Affected By
40	Amended	Improvements to IPSASs November 2010
41	Amended	IPSAS 31 January 2010
44	Amended	Improvements to IPSASs November 2010
66	Amended	IPSAS 31 January 2010
79	Deleted	IPSAS 33 January 2015
80	Deleted	IPSAS 33 January 2015
84A	New	Improvements to IPSASs November 2010
85A	New	Improvements to IPSASs November 2010
85B	New	IPSAS 32 October 2011
85C	New	IPSAS 33 January 2015
86	Amended	IPSAS 33 January 2015

IPSAS 13—LEASES

CONTENTS

International Public Sector Accounting Standard 13, *Leases*, is set out in paragraphs 1–87. All the paragraphs have equal authority. IPSAS 13 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe, 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 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 IPSAS 27, *Agriculture*); or**

   (d) **Biological assets provided by lessors under operating leases (see IPSAS 27).**

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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

5. 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 25–27.

6. This Standard does not apply to (a) lease agreements to explore for or use natural resources such as oil, gas, timber, metals, and other mineral rights, and (b) 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 that need to be addressed separately.

7. This Standard does not apply to investment property. Investment properties are measured by lessors and lessees in accordance with the provisions of IPSAS 16.

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 with 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.**

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:

(a) **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

(b) **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.

<u>Net investment in the lease</u> is the gross investment in the lease discounted at the interest rate implicit in the lease.

A <u>non-cancelable lease</u> 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 <u>operating lease</u> is a lease other than a finance lease.

<u>Unearned finance revenue</u> is the difference between:

(a) **The gross investment in the lease; and**

(b) **The net investment in the lease.**

<u>Unguaranteed residual value</u> 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.

<u>Useful life</u> 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 IPSASs are used in this Standard with the same meaning as in those Standards, and are reproduced in the *Glossary of Defined Terms* published separately.

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 (a) for changes in the construction or acquisition cost of the leased property, or (b) 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 that 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 that 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 (a) losses from idle capacity, technological obsolescence, or (b) 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 (a) if ownership of the asset transfers at the end of the lease for a variable payment equal to its then fair value, or (b) 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 12–17 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. [Deleted]

20. [Deleted]

20A. When a lease includes both land and buildings elements, an entity assesses the classification of each element as a finance or an operating lease separately in accordance with paragraphs 12–18. In determining whether the land element is an operating or a finance lease, an important consideration is that land normally has an indefinite economic life.

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. Other agreements may involve a public sector entity leasing infrastructure from the private sector. The entity determines whether the arrangement is a service concession arrangement, as defined in IPSAS 32, *Service Concession Arrangements: Grantor*.

26. Where an arrangement does not meet the conditions for recognition of a service concession asset in accordance with IPSAS 32 and the 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 a service concession arrangement as defined in IPSAS 32 or 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; if a lease has not arisen, entities account for those agreements by applying the provisions of other relevant IPSASs, 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 period 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 IPSAS 17, *Property, Plant, and Equipment,* and IPSAS 31, *Intangible Assets,* as appropriate. 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 IPSAS 21, *Impairment of Non-Cash-Generating Assets,* and IPSAS 26, *Impairment of Cash-Generating Assets*.

40. **Lessees shall disclose the following for finance leases:**

    (a) **For each class of assets, 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 surplus, return of capital contributions, dividends or similar distributions, additional debt, and further leasing.**

41. In addition, the requirements for disclosure in accordance with IPSAS 16, IPSAS 17, IPSAS 21, *Impairment of Non-Cash-Generating Assets*, IPSAS 26, *Impairment of Cash-Generating Assets*, and IPSAS 31, that 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 following 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 surplus, return of capital contributions, dividends or similar distributions, 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 that 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 what 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 that 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 that 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 what 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 or IPSAS 31, as appropriate.**

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 (a) there has been an impairment in value, and (b) that impairment is required to be recognized by any international and/or national accounting standard on impairment that 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.

Transitional Provisions

79. [Deleted]

80. [Deleted]

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 IPSASs 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 IPSASs 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).

84A. **An entity that has previously applied IPSAS 13 (2006) shall reassess the classification of land elements of unexpired leases at the date it adopts the amendments referred to in paragraph 85A on the basis of information existing at the inception of those leases. It shall recognize a lease newly classified as a finance lease retrospectively in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*. However, if an entity does not have the information necessary to apply the amendments retrospectively, it shall:**

(a) **Apply the amendments to those leases on the basis of the facts and circumstances existing on the date it adopts the amendments; and**

(b) **Recognize the asset and liability related to a land lease newly classified as a finance lease at their fair values on that date; any difference between those fair values is recognized in accumulated surplus or deficit.**

Effective Date

85. **An entity shall apply this 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.**

85A. **Paragraphs 19 and 20 were deleted, and paragraphs 20A and 84A were added by *Improvements to IPSASs* issued in November 2010. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2012. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2012, it shall disclose that fact.**

85B. **Paragraphs 25, 26 and 27 were amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 5, 7 and 107C of IPSAS 17, the amendments to paragraphs 2 and 125A of IPSAS 29 and the amendments to paragraphs 6 and 132A of IPSAS 31.**

85C. **Paragraphs 79, 80 and 86 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

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

Withdrawal of IPSAS 13 (2001)

87. This Standard supersedes IPSAS 13, *Leases*, issued in 2001.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 13.

Revision of IPSAS 13 as a result of the IASB's General Improvements Project 2003

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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 International Accounting Standards (IASs)[1] 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),[2] actioned an IPSAS improvement 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 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 http://www.iasb.org). In those cases

[1] 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.

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

where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

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.

Revision of IPSAS 13 as a result of the IASB's *Improvements to IFRSs* issued in 2009

BC7. The IPSASB reviewed the revisions to IAS 17 included in the *Improvements to IFRSs* issued by the IASB in April 2009 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendment.

Implementation Guidance

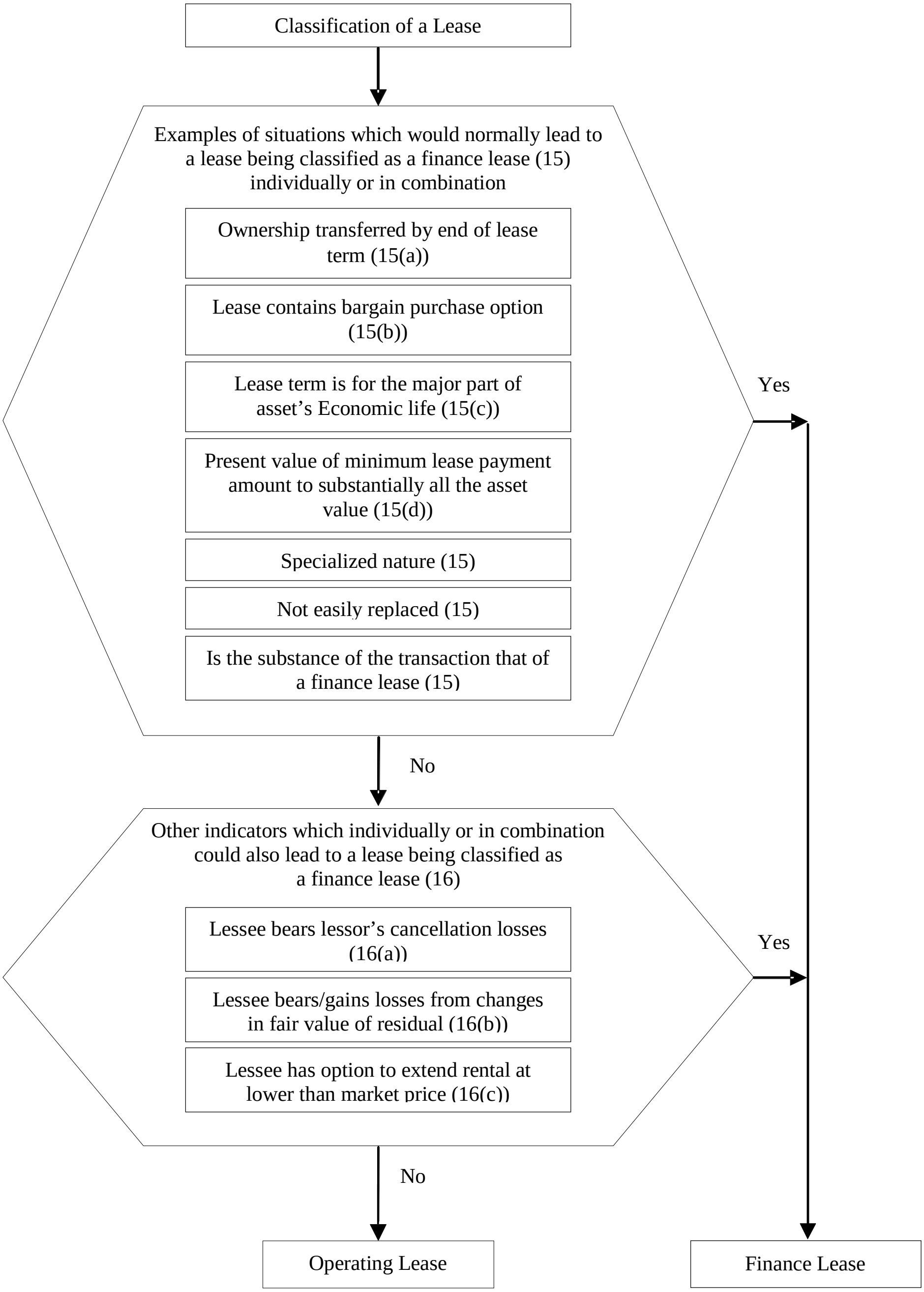
This guidance accompanies, but is not part of, IPSAS 13.

Classification of a Lease

IG1. 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.

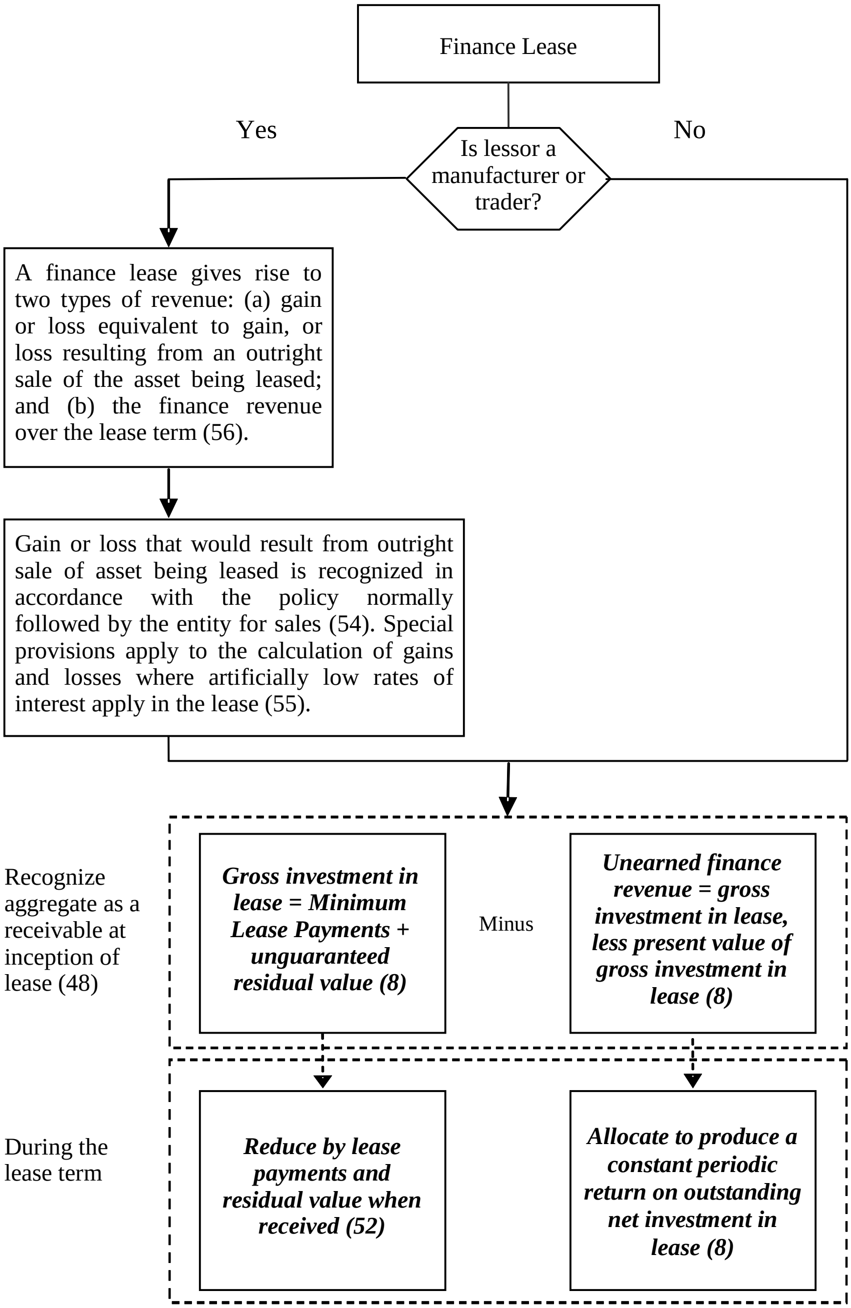
IG2. The examples contained in this chart do not necessarily reflect all possible situations in which a lease may be classified as a finance lease, nor should a lease necessarily be classified as a finance lease by virtue of the route followed in this chart. Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract (paragraph 15).

IG3. In the flowchart, the numbers in parentheses refer to paragraph numbers in this Standard.


Classification of a Lease
Examples of situations which would normally lead to a lease being classified as a finance lease (15) individually or in combination
Ownership transferred by end of lease term (15(a))
Lease contains bargain purchase option (15(b))
Lease term is for the major part of asset’s Economic life (15(c))
Present value of minimum lease payment amount to substantially all the asset value (15(d))
Specialized nature (15)
Not easily replaced (15)
Is the substance of the transaction that of a finance lease (15)
Yes
No
Other indicators which individually or in combination could also lead to a lease being classified as a finance lease (16)
Lessee bears lessor’s cancellation losses (16(a))
Lessee bears/gains losses from changes in fair value of residual (16(b))
Lessee has option to extend rental at lower than market price (16(c))
Yes
No
Operating Lease
Finance Lease

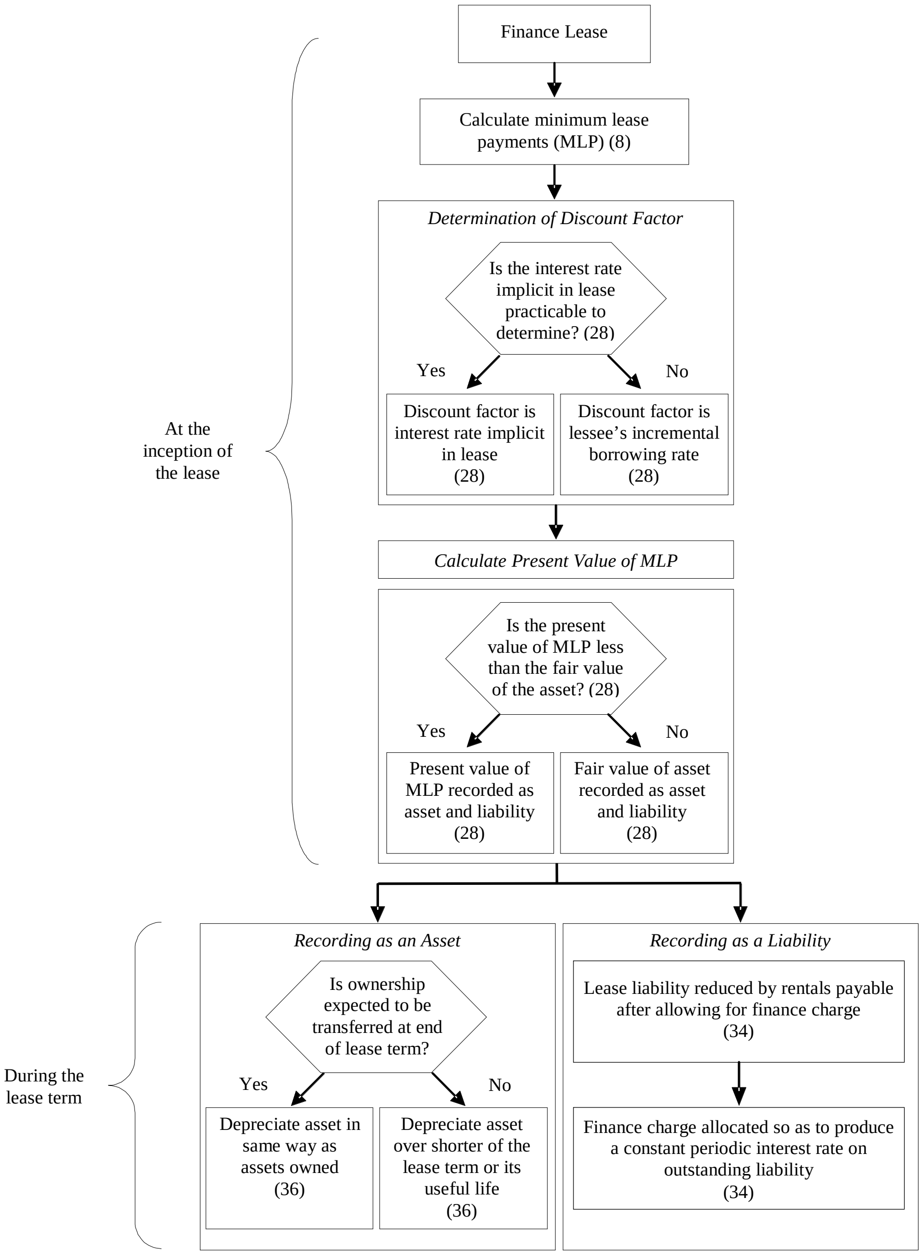
Accounting for a Finance Lease by a Lessor

IG4. In the flowchart, the numbers in parentheses refer to paragraph numbers in the Standard.



Accounting for a Finance Lease by a Lessee

IG5. In the flowchart, the numbers in parentheses refer to paragraph numbers in the Standard.



Sale and Leaseback Transactions that Result in Operating Leases

IG6. 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 this 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**
Gain	no gain	recognize gain immediately	no gain
Loss	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**
Gain	no gain	recognize gain immediately	no gain (note 1)
Loss <u>not</u> compensated by future lease payments at below market price	recognize loss immediately	recognize loss immediately	(note 1)
Loss compensated by future lease payments at below market price	defer and amortize loss	defer and amortize loss	(note 1)

Sale price above fair value (paragraph 65)	**Carrying amount equal to fair value**	**Carrying amount less than fair value**	**Carrying amount above fair value**
Gain	defer and amortize gain	defer and amortize gain (note 2)	defer and amortize gain (note 3)
Loss	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 this 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.

Calculating the Interest Rate Implicit in a Finance Lease

IG7. 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 guidance 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.

IG8. 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:

$$\mathrm{PV(MLP)} = \frac{S}{(1+r)^n} + \frac{A}{r}\left[1 - \frac{1}{(1+r)^n}\right]$$

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

IG8. 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 for 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

IG9. 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.

IG10. 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.

IG11. 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

IG12. At Department X's incremental borrowing rate of 7% (0.07) per annum (figures are rounded):

$$\text{PV(MLP)} = \frac{10{,}000}{(1+0.07)^4} + \frac{5{,}429}{0.07}\left[1 - \frac{1}{(1+0.07)^4}\right]$$

= 7,629 + 18,390

= 26,019

IG13. 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

IG14. 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

IG15. 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)

$$r = 7\% + (10\% - 7\%)\frac{1{,}019}{(1{,}019 + 960)}$$

$= \quad 7\% + (3\% \times 0.5)$

$= \quad 7\% + 1.5\%$

$= \quad 8.5\%$

IG16. 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.

Comparison with IAS 17

IPSAS 13, *Leases* is drawn primarily from IAS 17, *Leases* and includes amendments made to IAS 17 as part of the *Improvements to IFRSs* issued in April 2009. The main differences between IPSAS 13 and IAS 17 are as follows:

- 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 example is the use of the term "statement of financial performance" in IPSAS 13. The equivalent term in IAS 17 is "income statement."
- 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 that 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 Financial Reporting Standards (IFRS) Foundation.

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E-mail: publications@ifrs.org

Internet: www.ifrs.org

IPSAS 14—EVENTS AFTER THE REPORTING DATE

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 14, *Events After the Reporting Date* was issued in December 2001.

In December 2006 the IPSASB issued a revised IPSAS 14.

Since then, IPSAS 14 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)

Table of Amended Paragraphs in IPSAS 14

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
16	Amended	Improvements to IPSASs January 2010
32A	New	Improvements to IPSASs January 2010
32B	New	IPSAS 33 January 2015
33	Amended	IPSAS 33 January 2015

December 2006

IPSAS 14—EVENTS AFTER THE REPORTING DATE

CONTENTS

International Public Sector Accounting Standard 14, *Events After the Reporting Date*, is set out in paragraphs 1–34. All the paragraphs have equal authority. IPSAS 14 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe:

   (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 that 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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

Definitions

5. **The following term is used in this Standard with the meaning specified:**

   <u>Events after the reporting date</u> 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).**

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

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 (a) the publication of an announcement of the surplus or deficit, (b) the authorization of the financial statements of a controlled entity, or (c) 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 (a) whether they provide more information about the conditions existing at reporting date, and (b) 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 that 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 no obligation exists at that time. Such dividends or similar distributions are disclosed in the notes

in accordance with IPSAS 1. 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 (a) that there is an intention to liquidate the entity or to cease operating, or (b) 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. 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 the reporting date;

    (b) The entity decides after the 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 (see IPSAS 19);

(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. **An entity shall apply this 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.**

32A. **Paragraph 16 was amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged.**

32B **Paragraph 33 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.**

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

Withdrawal of IPSAS 14 (2001)

34. This Standard supersedes IPSAS 14, *Events after the Reporting Date*, issued in 2001.

Appendix

Amendments to Other IPSASs

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 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.

In IPSASs, 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, IPSAS 14.

Revision of IPSAS 14 as a result of the IASB's General Improvements Project 2003

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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[1] 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),[2] 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. (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 http://www.iasb.org). In those cases

1 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.

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

where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

BC6. IAS 10 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 14 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.

Revision of IPSAS 14 as a result of the IASB's Improvements to IFRSs issued in 2008

BC7. The IPSASB reviewed the revisions to IAS 10 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendment.

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* and includes an amendment made to IAS 10 as part of the *Improvements to IFRSs* issued in May 2008. 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 “net assets/equity,” and “reporting date” in IPSAS 14. The equivalent terms in IAS 10 are “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.”

International Public Sector Accounting Standard (IPSAS) 15, *Financial Instruments: Disclosure and Presentation* has been superseded by IPSAS 28, *Financial Instruments: Presentation*; IPSAS 29, *Financial Instruments: Recognition and Measurement*; and IPSAS 30, *Financial Instruments: Disclosures*. These Standards apply for annual financial statements covering periods beginning on or after January 1, 2013. As a result IPSAS 15 is no longer applicable and has been removed.

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 Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IPSAS 16—INVESTMENT PROPERTY

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 16, *Investment Property* was issued in December 2001.

In December 2006 the IPSASB issued a revised IPSAS 16.

Since then, IPSAS 16 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- IPSAS 27, *Agriculture* (issued December 2009)

Table of Amended Paragraphs in IPSAS 16

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
6	Amended	IPSAS 27 December 2009
12	Amended	Improvements to IPSASs January 2010
13	Amended	Improvements to IPSASs January 2010
29	Deleted	Improvements to IPSASs January 2010
40	Amended	Improvements to IPSASs January 2010
57	Amended	Improvements to IPSASs January 2010
59	Amended	Improvements to IPSASs January 2010
62	Amended	Improvements to IPSASs January 2010

Paragraph Affected	How Affected	Affected By
62A	New	Improvements to IPSASs January 2010
62B	New	Improvements to IPSASs January 2010
63	Amended	Improvements to IPSASs January 2010
66	Amended	Improvements to IPSASs January 2010
91	Deleted	IPSAS 33 January 2015
92	Deleted	IPSAS 33 January 2015
93	Deleted	IPSAS 33 January 2015
94	Deleted	IPSAS 33 January 2015
95	Deleted	IPSAS 33 January 2015
96	Deleted	IPSAS 33 January 2015
98	Deleted	IPSAS 33 January 2015
99	Deleted	IPSAS 33 January 2015
101A	New	Improvements to IPSASs January 2010
101B	New	IPSAS 33 January 2015
102	Amended	IPSAS 33 January 2015
Illustrative Decision Tree	Amended	Improvements to IPSASs January 2010

December 2006

IPSAS 16—INVESTMENT PROPERTY

CONTENTS

International Public Sector Accounting Standard 16, *Investment Property*, 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 Conclusions, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for 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. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

5. This Standard applies to accounting for investment property, including (a) the measurement in a lessee's financial statements of investment property interests held under a lease accounted for as a finance lease, and to (b) 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 IPSAS 13, *Leases*, including:

   (a) Classification of leases as finance leases or operating leases;

   (b) Recognition of lease revenue from investment property (see also 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.

6. This Standard does not apply to:

   (a) Biological assets related to agricultural activity (see IPSAS 27, *Agriculture*); and

   (b) Mineral rights and mineral reserves such as oil, natural gas, and similar non-regenerative resources.

Definitions

7. **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 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.

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.**

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

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, (a) the property would otherwise meet the definition of an investment property, and (b) 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. 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 that 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.

    (e) Property that is being constructed or developed for future use as investment property.

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 (see 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) [Deleted]

    (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) a portion that is held to earn rentals or for capital appreciation rather than to provide services, and (b) 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 (a) owns an office building that is held exclusively for rental purposes and rented on a commercial basis, and (b) 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 that 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 9–17. 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. [Deleted]

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 42–64) 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 results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows. It is highly unlikely that a change from the fair value model to the cost model will result in a more relevant 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 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 IPSAS 26, *Impairment of Cash-Generating Assets*. 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 carrying amount of investment property under the fair value model, 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 carrying amount of the investment property using the fair value model.

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 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. If an entity determines that the fair value of an investment property under construction is not reliably determinable but expects the fair value of the property to be reliably determinable when construction is complete, it shall measure that investment property under construction at cost until either its fair value becomes reliably determinable or construction is completed (whichever is earlier). If an entity determines that the fair value of an investment property (other than an investment property under construction) is not reliably determinable on a continuing basis, the entity shall measure that investment property using the cost model in IPSAS 17. 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.**

62A. Once an entity becomes able to measure reliably the fair value of an investment property under construction that has previously been measured at cost, it shall measure that property at its fair value. Once construction of that property is complete, it is presumed that fair value can be measured reliably. If this is not the case, in accordance with paragraph 62, the property shall be accounted for using the cost model in accordance with IPSAS 17.

62B. The presumption that the fair value of investment property under construction can be measured reliably can be rebutted only on initial recognition. An entity that has measured an item of investment property under construction at fair value may not conclude that the fair value of the completed investment property cannot be determined reliably.

63. In the exceptional cases when an entity is compelled, for the reason given in paragraph 62, to measure an investment property using the cost model in accordance with IPSAS 17, it measures at fair value all its other investment property, including investment property under construction. 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; or**

    (d) **Commencement of an operating lease (on a commercial basis) to another party, for a transfer from inventories to investment property.**

(e) [Deleted]

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, 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) if no impairment loss had 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 Implementation Guidance 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 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 or IPSAS 26, as appropriate;

(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; and**

(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) **The 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 or IPSAS 26, as appropriate;**

(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

91. [Deleted]

92. [Deleted]

93. [Deleted]

Fair Value Model

94. [Deleted]

95. [Deleted]

96. [Deleted]

97. An entity that (a) has previously applied IPSAS 16 (2001), and (b) 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. [Deleted]

99. [Deleted]

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 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.**

101A. **Paragraphs 12, 13, 40, 57, 59, 62, 63, and 66 were amended, paragraph 29 was deleted and paragraphs 62A and 62B were added by *Improvements to IPSASs* issued in January 2010. An entity shall apply those amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2011. An entity is encouraged to apply the amendments to investment property under construction from any date before January 1, 2011 provided that the fair values of investment properties under construction were determined at those dates. If an entity applies the amendments for a period beginning before January 1, 2011, it shall disclose that fact and at the same time apply the amendments to paragraphs 8 and 107A of IPSAS 17.**

101B. **Paragraphs 91, 92, 93, 94, 95, 96, 98, 99 and 102 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

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

Withdrawal of IPSAS 16 (2001)

103. This Standard supersedes IPSAS 16, *Investment Property*, issued in 2001.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 16.

Revision of IPSAS 16 as a result of the IASB's General Improvements Project 2003

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the IPSASB's work program. The IPSASB 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 International Accounting Standards (IASs)[1] 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),[2] 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 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 http://www.iasb.org). In those cases

[1] 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.

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

where the IPSAS departs from its related IAS, the Basis for Conclusions explains the public sector-specific reasons for the departure.

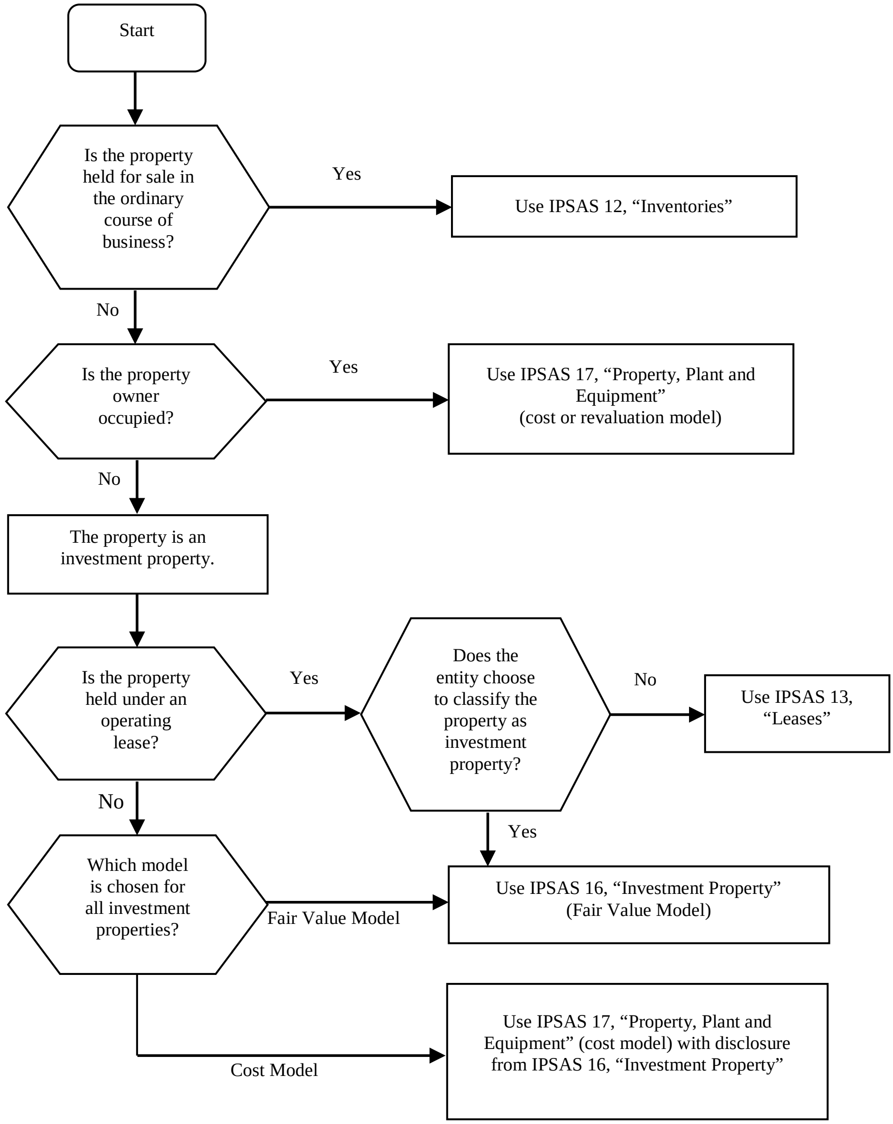
BC6. IAS 40 has been further amended as a consequence of IFRSs issued after December 2003. IPSAS 16 does not include the consequential amendments arising from IFRSs issued after December 2003. This is because the IPSASB has not yet reviewed and formed a view on the applicability of the requirements in those IFRSs to public sector entities.

Revision of IPSAS 16 as a result of the IASB's Improvements to IFRSs issued in 2008

BC7. The IPSASB reviewed the revisions to IAS 40 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendments.

Illustrative Decision Tree

This decision tree accompanies, but is not part of, IPSAS 16.



Comparison with IAS 40

IPSAS 16 is drawn primarily from IAS 40 (2003), *Investment Property* and includes amendments made to IAS 40 as part of the *Improvements to IFRSs* issued in May 2008. 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 IFRSs. 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 that 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 that 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 example is the use of the term "statement of financial performance" in IPSAS 16. The equivalent term in IAS 40 is "income statement."
- 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 Financial Reporting Standards (IFRS) Foundation.

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E-mail: publications@ifrs.org

Internet: www.ifrs.org

IPSAS 17—PROPERTY, PLANT, AND EQUIPMENT

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 17, *Property, Plant, and Equipment* was issued in December 2001.

In December 2006 the IPSASB issued a revised IPSAS 17.

Since then, IPSAS 17 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2014* (issued January 2015)
- IPSAS 32, *Service Concession Arrangements: Grantor* (issued October 2011)
- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- IPSAS 27, *Agriculture* (issued December 2009)
- IPSAS 31, *Intangible Assets* (issued January 2010)

Table of Amended Paragraphs in IPSAS 17

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
5	Amended	IPSAS 32 October 2011
6	Amended	IPSAS 27 December 2009
7	Amended	IPSAS 32 October 2011
8	Amended	Improvements to IPSASs January 2010
17	Amended	Improvements to IPSASs January 2015
50	Amended	Improvements to IPSASs January 2015
65	Amended	IPSAS 31 January 2010
72	Amended	Improvements to IPSASs

Paragraph Affected	How Affected	Affected By
		January 2015
78A	New	Improvements to IPSASs January 2015
79	Amended	Improvements to IPSASs October 2011
81	Amended	Improvements to IPSASs October 2011
83	Amended	Improvements to IPSASs October 2011
83A	New	Improvements to IPSASs January 2010
84	Amended	Improvements to IPSASs January 2010
88	Amended	Improvements to IPSASs October 2011
93	Amended	Improvements to IPSASs October 2011
95	Deleted	IPSAS 33 January 2015
96	Deleted	IPSAS 33 January 2015
97	Deleted	IPSAS 33 January 2015
98	Deleted	IPSAS 33 January 2015
99	Deleted	IPSAS 33 January 2015
100	Deleted	IPSAS 33 January 2015
101	Deleted	IPSAS 33 January 2015
102	Deleted	IPSAS 33 January 2015
103	Deleted	IPSAS 33 January 2015
104	Deleted	IPSAS 33 January 2015
106A	New	Improvements to IPSASs January 2015
107A	New	Improvements to IPSASs January 2010

Paragraph Affected	How Affected	Affected By
107B	New	Improvements to IPSASs January 2010
107C	New	IPSAS 32 October 2011
107D	New	Improvements to IPSASs October 2011
107E	New	Improvements to IPSASs January 2015
107F	New	IPSAS 33 January 2015
108	Amended	IPSAS 33 January 2015

IPSAS 17—PROPERTY, PLANT, AND EQUIPMENT

CONTENTS

International Public Sector Accounting Standard 17, *Property, Plant, and Equipment*, is set out in paragraphs 1–109. All the paragraphs have equal authority. IPSAS 17 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for 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 (a) the recognition of the assets, (b) the determination of their carrying amounts, and (c) 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 IPSAS; 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. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

5. This Standard applies to property, plant, and equipment including:

   (a) Specialist military equipment;

   (b) Infrastructure assets; and

   (c) Service concession arrangement assets after initial recognition and measurement in accordance with IPSAS 32, *Service Concession Arrangements: Grantor*.

   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.

6. This Standard does not apply to:

   (a) Biological assets related to agricultural activity (see IPSAS 27, *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 6(a) or 6(b).

7. Other IPSASs 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. IPSAS 32 requires an entity to evaluate the recognition of an item of property, plant, and equipment used in a service concession arrangement on the basis of control of the asset. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

8. An entity using the cost model for investment property in accordance with IPSAS 16, *Investment Property* shall use the cost model in this Standard.

Heritage Assets

9. 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.

10. 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.

11. Some heritage assets have future economic benefits or 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 future economic benefit or service potential is limited to their heritage characteristics, for example, monuments and ruins. The existence of both future economic benefits and service potential can affect the choice of measurement base.

12. The disclosure requirements in paragraphs 88–94 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.

Definitions

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

    <u>Carrying amount</u> (for the purpose of this Standard) is the amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.

    <u>Class of property, plant and equipment</u> 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.

    <u>Depreciable amount</u> is the cost of an asset, or other amount substituted for cost, less its residual value.

    <u>Depreciation</u> is the systematic allocation of the depreciable amount of an asset over its useful life.

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.

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.

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

Recognition

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. Items such as spare parts, stand-by equipment and servicing equipment are recognized in accordance with this IPSAS when they meet the definition of property, plant, and equipment. Otherwise, such items are classified as inventory.

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 82–87).

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 45–50, 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 IPSAS 25, *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). 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.

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 54–56.

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, the carrying amount of that asset is adjusted to the revalued amount. At the date of the revaluation, the asset is treated in one of the following ways:

    (a) The gross carrying amount is adjusted in a manner that is consistent with the revaluation of the carrying amount of the asset. For example, the gross carrying amount may be restated by reference to observable market data or it may be restated proportionately to the change in the carrying amount. The accumulated depreciation at the date of the revaluation is adjusted to equal the difference between the gross carrying amount and the carrying amount of the asset after taking into account accumulated impairment losses; or

    (b) The accumulated depreciation is eliminated against the gross carrying amount of the asset.

    The amount of the adjustment 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 IPSAS 31, *Intangible Assets*.

Depreciable 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 asset 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. Expected future reductions in the selling price of an item that was produced using an asset could indicate the expectation of technical or commercial obsolescence of the asset, which, in turn, might reflect a reduction of the future economic benefits or service potential embodied in the asset.

(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.

78A. A depreciation method that is based on revenue that is generated by an activity that includes the use of an asset is not appropriate. The revenue generated by an activity that includes the use of an asset generally reflects factors other than the consumption of the economic benefits or service potential of the asset. For example, revenue is affected by other inputs and processes, selling activities and changes in sales volumes and prices. The price component of revenue may be affected by inflation, which has no bearing upon the way in which an asset is consumed.

Impairment

79. To determine whether an item of property, plant, and equipment is impaired, an entity applies IPSAS 21 or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate. These Standards explain 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 or IPSAS 26, as appropriate;

    (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 requires otherwise on a sale and leaseback).**

83A. However, an entity that, in the course of its ordinary activities, routinely sells items of property, plant and equipment that it has held for rental to others shall transfer such assets to inventories at their carrying amount when they cease to be rented and become held for sale. The proceeds from the sale of such assets shall be recognized as revenue in accordance with IPSAS 9, *Revenue from Exchange Transactions*.

84. The disposal of an item of property, plant and equipment may occur in a variety 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 for recognizing revenue from the sale of goods. IPSAS 13 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 or IPSAS 26, as appropriate;**

        (v) **Impairment losses recognized in surplus or deficit in accordance with IPSAS 21 or IPSAS 26, as appropriate;**

        (vi) **Impairment losses reversed in surplus or deficit in accordance with IPSAS 21 or IPSAS 26, as appropriate;**

        (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 and IPSAS 26, an entity discloses information on impaired property, plant, and equipment in addition to the information required by paragraph 88(e)(iv)–(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. [Deleted]

96. [Deleted]

97. [Deleted]

98. [Deleted]

99. [Deleted]

100. [Deleted]

101. [Deleted]

102. [Deleted]

103. [Deleted]

104. [Deleted]

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.

106A. Paragraph 50 was amended by *Improvements to IPSASs 2014* issued in January 2015. An entity shall apply those amendments to all revaluations recognized in annual periods beginning on or after the date of initial application of that amendment and in the immediately preceding annual period.

Effective Date

107. **An entity shall apply this 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.**

107A. **Paragraph 83A was added and paragraph 84 was amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2011, it shall disclose that fact and at the same time apply the related amendment to IPSAS 2, *Cash Flow Statements*.**

107B. **Paragraph 8 was amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply that amendment prospectively for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged if an entity also applies the amendments to paragraphs 12, 13, 29, 40, 57, 59, 62, 62A, 62B, 63, 66, and 101A of IPSAS 16 at the same time. If an entity applies the amendment for a period beginning before January 1, 2011, it shall disclose that fact.**

107C. **Paragraphs 5 and 7 were amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply**

those amendments for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 2 and 125A of IPSAS 29 and the amendments to paragraphs 6 and 132A of IPSAS 31.

107D. **Paragraphs 79, 81, 83, 88 and 93 were amended by *Improvements to IPSASs 2011* issued in October 2011. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2013, it shall disclose that fact.**

107E. **Paragraphs 17, 50 and 72 were amended and paragraphs 78A and 106A added by *Improvements to IPSASs 2014* issued in January 2015. An entity shall apply those amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2015. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2015, it shall disclose that fact.**

107F. **Paragraphs 95, 96, 97, 98, 99, 100, 101, 102, 103, 104 and 108 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

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

Withdrawal of IPSAS 17 (2001)

109. This Standard supersedes IPSAS 17, *Property, Plant, and Equipment*, issued in 2001.

Appendix

Amendments to Other IPSASs

In IPSAS 18, *Segment Reporting*, paragraph 37 is amended to read as follows:

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.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 17.

Revision of IPSAS 17 as a result of the IASB's General Improvements Project 2003

Background

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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 International Accounting Standards (IASs) [1] 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), *Property, Plant, and Equipment,* which was reissued in December 2003. In late 2003, the IPSASB's predecessor, the Public Sector Committee (PSC), [2] 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 exception noted in paragraph BC6. (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

1 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.

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

at http://www.iasb.org). In those cases where the IPSAS departs from its related IAS, this Basis for Conclusions explains the public sector-specific reasons for the departure.

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." 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 IPSAS 17 is the same as in IPSAS 26, *Impairment of Cash-Generating 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 service amount in accordance with IPSAS 21, *Impairment of Non-Cash-Generating Assets*.

(b) IPSAS 21 requires an entity to determine the recoverable amount in accordance with IPSAS 26.

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.

Revision of IPSAS 17 as a result of the IASB's *Improvements to IFRSs* issued in 2008

BC8. The IPSASB reviewed the revisions to IAS 16 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendments.

Revision of IPSAS 17 as a result of IASB's *Improvements to IFRSs* and *Narrow Scope Amendments* issued in May 2012, December 2013 and May 2014

BC9. The IPSASB reviewed the revisions to IAS 16 included in the *Improvements to IFRSs* and *Clarification of Acceptable Methods of Depreciation and Amortisation* issued by the IASB in May 2012, December 2013 and May 2014 and generally concurred that there was no public sector specific reason for not adopting the amendments.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 17.

Frequency of Revaluation of Property, Plant, and Equipment

IG1. Paragraph 44 of IPSAS 17 requires entities that adopt the revaluation model to measure assets at a revaluated amount that 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 a 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.

Illustrative Example

Disclosures

IE1. 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.

Reconciliations

(in '000 of currency units)

	Land		**Buildings**		**Machinery**		**Furniture and Fixtures**	
Reporting Period	**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

Comparison with IAS 16

IPSAS 17 is drawn primarily from IAS 16 (2003), *Property, Plant and Equipment* and includes amendments made to IAS 16 as part of the *Improvements to IFRSs* issued in May 2008. 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 17 does not reflect amendments made to IAS 16 consequent upon the issue of 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 that 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 assets 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 IPSASs. 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," and "net assets/equity" in IPSAS 17. The equivalent terms in IAS 16 are "income statement" 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 Financial Reporting Standards (IFRS) Foundation.

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IPSAS 18—SEGMENT REPORTING

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 18, *Segment Reporting* was issued in June 2002.

Since then, IPSAS 18 has been amended by the following IPSASs:

- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* (issued December 2006)
- IPSAS 17, *Property, Plant, and Equipment* (issued December 2006)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 18

Paragraph Affected	How Affected	Affected By
27[1]	Amended	IPSAS 37 Janaury 2015 IPSAS 3 December 2006
32	Amended	IPSAS 37 January 2015
37	Amended	IPSAS 17 December 2006
41	Amended	IPSAS 35 January 2015
57	Amended	IPSAS 3 December 2006
69	Amended	IPSAS 3 December 2006
70	Amended	IPSAS 3 December 2006
76A	New	IPSAS 33 January 2015
77	Amended	IPSAS 33 January 2015
IE	Amended	IPSAS 3 December 2006 Improvements to IPSASs

[1] Sub-paragraphs have been renumbered.

Paragraph Affected	How Affected	Affected By
		November 2010

June 2002

IPSAS 18—SEGMENT REPORTING

CONTENTS

International Public Sector Accounting Standard 18, *Segment Reporting*, is set out in the objective and paragraphs 1–77. All the paragraphs have equal authority. IPSAS 18 should be read in the context of its objective, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

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 that prepares and presents financial statements under the accrual basis of accounting shall 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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

4. **This Standard shall be applied in complete sets of published financial statements that comply with 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.

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 that contains the government's or other controlling entity's consolidated financial statements needs to present segment information only for the consolidated financial statements.

Definitions

8. [Deleted]

9. **The following term is used in this Standard with the meaning specified:**

A <u>segment</u> 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 (a) evaluating the entity's past performance in achieving its objectives, and (b) making decisions about the future allocation of resources.

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

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 (a) the assets controlled and liabilities incurred by the reporting entity, (b) the cost of services provided, and (c) 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 shall identify its separate segments in accordance with the requirements of paragraph 9 of this Standard, and shall present information about those segments as required by paragraphs 51–75 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 (a) evaluating the past performance of the entity in achieving its objectives, and (b) making decisions about the allocation of resources by the entity. In addition to disclosure of the information required by paragraphs 51–75 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 (a) to discharge their managerial responsibilities and to evaluate the performance of the entity in achieving its objectives in the past, and (b) to make decisions about the allocation of resources by the entity in the future.

15. Determining the activities that 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 A of IPSAS 1. These characteristics are also summarized in the Implementation Guidance 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 IASB *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 that 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 (a) major outputs are identified, (b) their achievements monitored, and (c) their resource needs identified and budgeted. An example of an entity that 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 that (a) reflects general government, public finance sector and trading sector disclosures, and (b) supplements 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 that 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 that 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 (a) evaluating the past performance of the entity's major activities in achieving their objectives, and (b) 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 that 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:**

<u>Segment accounting policies</u> 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.

<u>Segment assets</u> 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 are determined after deducting related allowances that are reported as direct offsets in the entity's statement of financial position.

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.**

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 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 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.

<u>Segment revenue</u> 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.

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 (a) the costs of providing certain groups of goods and services or of undertaking certain activities, and (b) 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 that 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 Standard.

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 that 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.

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 that 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 that 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 IPSASs. 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, *Cash Flow Statements* 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 35, *Consolidated 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 shall 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 shall 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 shall 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 shall be applied to each segment.**

52. **An entity shall 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 shall be separately reported.

53. **An entity shall disclose the total carrying amount of segment assets for each segment.**

54. **An entity shall disclose the total carrying amount of segment liabilities for each segment.**

55. **An entity shall 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 that 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 that 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 shall 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 shall also be disclosed by segment.**

64. **An entity shall 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 shall 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 shall be reconciled to a comparable measure of entity expense; segment assets shall be reconciled to entity assets; and segment liabilities shall 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 shall be measured on the basis that they occur. The basis of pricing inter-segment transfers and any change therein shall be disclosed in the financial statements.**

68. **Changes in accounting policies adopted for segment reporting that have a material effect on segment information shall be disclosed, and prior period segment information presented for comparative purposes shall be restated, unless it is impracticable to do so. Such disclosure shall 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 shall 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, *Accounting Policies, Changes in Accounting Estimates and*

Errors. IPSAS 3 requires that changes in accounting policy be made only (a) if required by an IPSAS, or (b) if the change will result in reliable and more relevant information about transactions, other events, and 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 shall 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. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after July 1, 2003. Earlier application is encouraged. If an entity applies this Standard for a period beginning before July 1, 2003, it shall disclose that fact.**

76A. **Paragraph 77 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.**

76B. **IPSAS 37, *Joint Arrangements,* issued in January 2015, amended paragraphs 27 and 32. An entity shall apply those amendments when it applies IPSAS 37.**

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

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 18.

Summary of Required Disclosures

[¶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]

Qualitative Characteristics of Financial Reporting

IG1. 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 guidance summarizes the qualitative characteristics of financial reporting.

IG2. 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

IG3. 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.

IG4. 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

IG5. 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

IG6. The relevance of information is affected by its nature and materiality.

IG7. 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 that information must have if it is to be useful.

Reliability

IG8. 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

IG9. 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

IG10. 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

IG11. 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

IG12. 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.

IG13. 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

IG14. The information in financial statements should be complete within the bounds of materiality and cost.

Comparability

IG15. Information in financial statements is comparable when users are able to identify similarities and differences between that information and information in other reports.

IG16. Comparability applies to the:

(a) comparison of financial statements of different entities; and

(b) comparison of the financial statements of the same entity over periods of time.

IG17. 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.

IG18. 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

IG19. 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

IG20. 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

IG21. 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.

Illustrative Example

This example accompanies, but is not part of, IPSAS 18.

The schedule and related note presented in this example illustrate the segment disclosures that this Standard would require for an education authority that is predominantly funded by appropriation, but (a) provides some educational services on a commercial basis to the employees of major corporations, and (b) has joined with a commercial venture to establish a private education foundation that 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.

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**
SEGMENT REVENUE												
Appropriation	48	40	22	23	10	10	7	7				
Fees from external sources	5	4	–	–	9	6	–	–				
Inter-segment transfers	10	6	6	7	2	4	2	2				
Total Segment Revenue	63	50	28	30	21	20	9	9	20	19	101	90
SEGMENT EXPENSE												
Salaries and wages	(39)	(31)	(13)	(13)	(13)	(13)	(2)	(2)				
Depreciation	(9)	(7)	(5)	(7)	(5)	(3)	(1)	(1)				
Other expenses	(12)	(11)	(10)	(9)	(5)	(5)	(2)	(2)				
Total Segment Expenses	(60)	(49)	(28)	(29)	(23)	(21)	(5)	(5)	20	19	(96)	(85)
Unallocated central expenses											(7)	(9)
Deficit from Operating Activities											(2)	(4)
Interest expense											(4)	(3)
Interest revenue											2	3
Share of net surpluses of associates							8	7			8	7

	Primary/ Secondary		Tertiary		Special Services		Other Services		Eliminations		Consolidated	
	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1
Surplus for the period											4	3
OTHER INFORMATION												
Segment assets	54	50	34	30	10	10	10	9			108	99
Investment in associates (equity method)							32	26			32	26
Unallocated central assets											35	30
Consolidated Total Assets											175	155
Segment liabilities	25	15	8	11	8	8	1	1			42	35
Unallocated corporate liabilities											40	55
Consolidated Total Liabilities											82	90
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	–	–				

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.

Comparison with IAS 14

IPSAS 18 is drawn primarily from IAS 14 (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 “revenue,” “statement of financial performance,” and “net assets/equity.” The equivalent terms in IAS 14 are “income,” “income statement,” 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 Financial Reporting Standards (IFRS) Foundation.

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IPSAS 19—PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* was issued in October 2002.

Since then, IPSAS 19 has been amended by the following IPSASs:

- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* (issued December 2006)
- IPSAS 14, *Events after the Reporting Date* (issued December 2006)

Table of Amended Paragraphs in IPSAS 19

Paragraph Affected	How Affected	Affected By
1	Amended	Improvements to IPSASs October 2011
4	Amended	Improvements to IPSASs October 2011
5	Deleted	Improvements to IPSASs October 2011
37	Amended	IPSAS 37 January 2015
87	Amended	IPSAS 14 December 2006
110	Deleted	IPSAS 33 January 2015
111[1]	Deleted	IPSAS 3 December 2006
111A	New	Improvements to IPSASs October 2011
111B	New	IPSAS 33 January 2015

[1] Paragraph 111 was a transitional provision. Subsequent paragraphs have been renumbered.

Paragraph Affected	How Affected	Affected By
111C	New	IPSAS 37 January 2015
112	Amended	IPSAS 33 January 2015
IG14	Amended	Improvements to IPSASs October 2011

October 2002

IPSAS 19—PROVISIONS, CONTINGENT LIABILITIES AND CONTINGENT ASSETS

CONTENTS

International Public Sector Accounting Standard 19, *Provisions, Contingent Liabilities and Contingent Assets*, is set out in the objective and paragraphs 1–112. All the paragraphs have equal authority. IPSAS 19 should be read in the context of its objective, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

The objective of this Standard is to (a) define provisions, contingent liabilities, and contingent assets, and (b) 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 that prepares and presents financial statements under the accrual basis of accounting shall 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) **[Deleted]**

    (c) **Those resulting from executory contracts, other than where the contract is onerous, subject to other provisions of this paragraph;**

    (d) **Insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts;**

    (e) **Those covered by another IPSAS;**

    (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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

4. This Standard does not apply to financial instruments (including guarantees) that are within the scope of IPSAS 29, *Financial Instruments: Recognition and Measurement*.

5. [Deleted]

6. This Standard applies to provisions for restructuring (including discontinued operations). In some cases, a restructuring may meet the definition of a discontinued operation. Guidance on disclosing information about discontinued operations can be found in IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.

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.

8. In many cases, obligations to provide social benefits arise as a consequence of a government's commitment to undertake particular activities on an ongoing 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 (a) the determination of what constitutes the obligating event, and (b) 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 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 IPSAS 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 IPSAS 25, *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 IPSASs 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 <u>constructive obligation</u> 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 <u>contingent asset</u> 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 <u>contingent liability</u> 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.**

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.**

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

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 shall 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 shall 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. 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 shall 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 arrangement debt, that part of the obligation that is to be met by other joint arrangement 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 shall not recognize a contingent asset.**

40. Contingent assets usually arise from unplanned or other unexpected events that (a) are not wholly within the control of the entity, and (b) 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 shall 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% of nil) + (20% of 1m) + (5% of 4m) = 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 midpoint 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.

Risks and Uncertainties

50. **The risks and uncertainties that inevitably surround many events and circumstances shall 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 shall 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.

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 (see Illustrative Example).

55. 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) shall 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) shall 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 shall 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 that 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 (a) of what legislation will demand, and (b) 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 shall 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 IPSAS 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 shall be recognized when, and only when, it is virtually certain that reimbursement will be received if the entity settles the obligation. The reimbursement shall be treated as a separate asset. The amount recognized for the reimbursement shall 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 shall 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 shall 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 shall 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 shall 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 IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate.

Onerous Contracts

76. **If an entity has a contract that is onerous, the present obligation (net of recoveries) under the contract shall 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 that 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 83–96 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 (a) the public announcement of the main features of the plan, (b) the sale or transfer of assets, (c) notification of intention to cancel leases, or (d) 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, (a) 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 (b) 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 IPSASs, such as IPSAS 14, and IPSAS 20, *Related Party Disclosures*.

Restructuring Provisions

93. **A restructuring provision shall 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 shall 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 shall 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 shall 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 shall 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 shall 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 44–62;**

(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 shall 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 44–62.**

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 shall be stated.**

109. **In extremely rare cases, disclosure of some or all of the information required by paragraphs 97–107 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 shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.**

Transitional Provision

110. [Deleted]

Effective Date

111. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2004. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2004, it shall disclose that fact.**

111A. **Paragraph 5 was deleted and paragraphs 1 and 4 were amended by *Improvements to IPSASs 2011* issued in October 2011. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2013, it shall disclose that fact.**

111B. **Paragraphs 110 and 112 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

111C. **IPSAS 37, *Joint Arrangements*, issued in January 2015, amended paragraph 37. An entity shall apply that amendment when it applies IPSAS 37.**

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

Tables

Provisions, Contingent Liabilities, Contingent Assets, and Reimbursements

These Tables accompany, but are not part of, IPSAS 19.

Provisions and Contingent Liabilities

<table>
<tr><td colspan="3">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.</td></tr>
<tr><td>There is a present obligation that probably requires an outflow of resources.</td><td>There is a possible obligation or a present obligation that may, but probably will not, require an outflow of resources.</td><td>There is a possible obligation or a present obligation where the likelihood of an outflow of resources is remote.</td></tr>
<tr><td>A provision is recognized (paragraph 22).</td><td>No provision is recognized (paragraph 35).</td><td>No provision is recognized (paragraph 35).</td></tr>
<tr><td>Disclosures are required for the provision (paragraphs 97 and 98).</td><td>Disclosures are required for the contingent liability (paragraph 100).</td><td>No disclosure is required (paragraph 100).</td></tr>
</table>

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

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.		
The inflow of economic benefits or service potential is virtually certain.	**The inflow of economic benefits or service potential is probable, but not virtually certain.**	**The inflow of economic benefits or service potential is not probable.**
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).

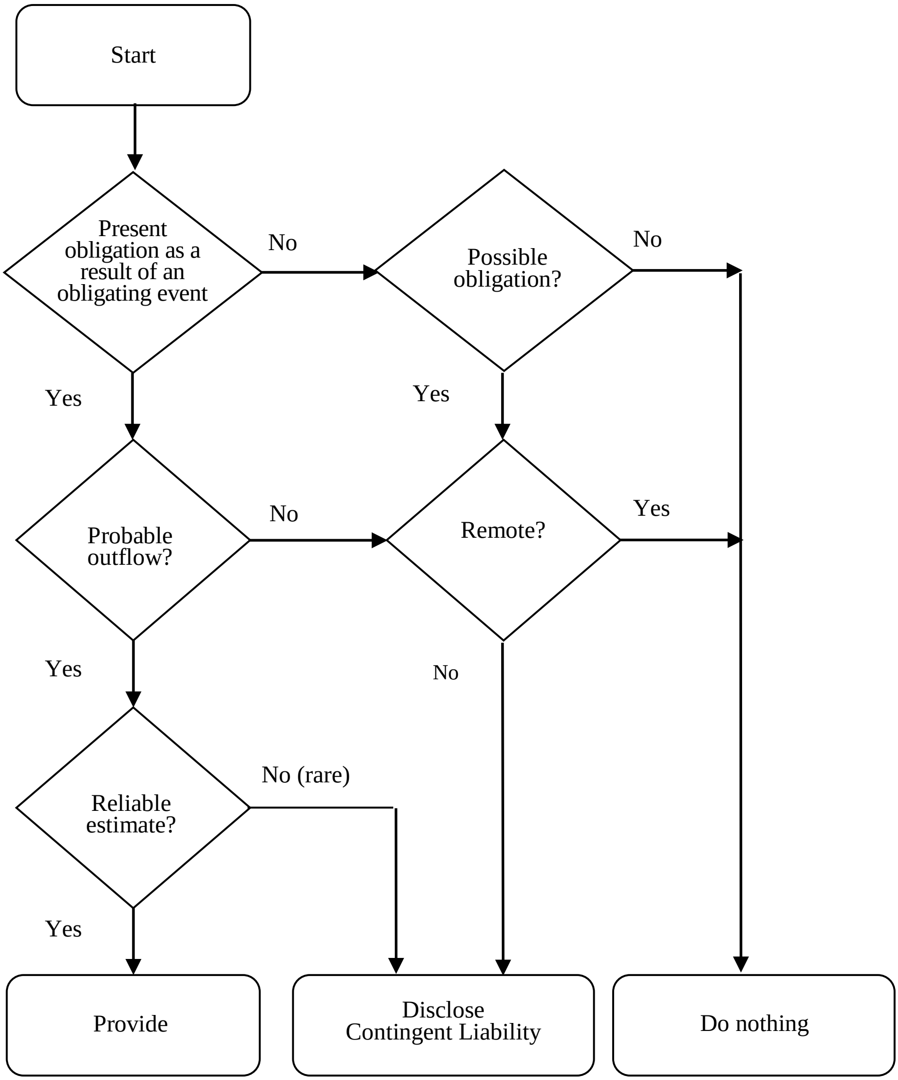
Reimbursements

Some or all of the expenditure required to settle a provision is expected to be reimbursed by another party.		
The entity has no obligation for the part of the expenditure to be reimbursed by the other party.	**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.**	**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.**
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)).

Illustrative Decision Tree

This decision tree accompanies, but is not part of, IPSAS 19.

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 this Standard).



Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 19.

Recognition

IG1. 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.

IG2. The cross-references provided in the examples indicate paragraphs of this Standard that are particularly relevant. This guidance should be read in the context of the full text of this Standard.

IG3. References to "best estimate" are to the present value amount, where the effect of the time value of money is material.

Warranties

IG4. 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).

Contaminated Land—Legislation Virtually Certain to be Enacted

IG5. 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 – Probable.

Conclusion

A provision is recognized for the best estimate of the costs of the clean-up (see paragraphs 22 and 30).

Contamination and Constructive Obligation

IG6. 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).

Gravel Quarry

IG7. 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.

Refunds Policy

IG8. 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).

Closure of a Division—No Implementation before Reporting Date

IG9. 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).

Outsourcing of a Division—Implementation Before the Reporting Date

IG10. 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).

Legal Requirement to Fit Air Filters

IG11. 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).

Analysis

(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).

Staff Retraining as a Result of Changes in the Income Tax System

IG12. 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).

An Onerous Contract

IG13. 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).

A Single Guarantee

IG14. 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.

This contract meets the definition of a financial guarantee contract in IPSAS 29, except those where the issuer elects to treat such contracts as insurance contracts in accordance with the relevant international or national accounting standard dealing with insurance contracts. The following is an example of an accounting policy that complies with the requirements in IPSAS 29 for financial guarantee contracts within the scope of IPSAS 29.

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

The guarantee is recognized at fair value.

Analysis

(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

The guarantee is subsequently measured at the higher of (a) the best estimate of the obligation (see paragraphs 22, 31 and 109), and (b) the amount initially recognized less, when appropriate, cumulative amortization in accordance with IPSAS 9, *Revenue from Exchange Transactions*.

A Court Case

IG15. 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).

Analysis

(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).

Repairs and Maintenance

IG16. 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.

Refurbishment Costs—No Legislative Requirement

IG17. 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.

Refurbishment Costs—Legislative Requirement

IG18. 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.

Disclosures

Two examples of the disclosures required by paragraph 98 are provided below.

Warranties

IG19. 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.

Decommissioning Costs

IG20. 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%.

Disclosure Exemption

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.

IG21. 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.

Illustrative Example

This example accompanies, but is not part of, IPSAS 19.

Present Value of a Provision

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).

IE1. 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 that takes account of the risk associated with this cash flow has been estimated at 12%.

IE2. 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 is drawn primarily from IAS 37 (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 “revenue” and “statement of financial performance” in IPSAS 19. The equivalent terms in IAS 37 are “income” and “income statement.”
- IPSAS 19 contains the definitions of technical terms used in IAS 37, and an additional definition for “executory contracts.”
- The Implementation Guidance has been amended to be more reflective of the public sector.
- IPSAS 19 contains an Illustrated Example that 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.

IPSAS 20—RELATED PARTY DISCLOSURES

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 24 (Reformatted 1994), *Related Party Disclosures*, published by the International Accounting Standards Board (IASB). Extracts from IAS 24 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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E-mail: publications@ifrs.org

Internet: www.ifrs.org

IPSAS 20—RELATED PARTY DISCLOSURES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 20, *Related Party Disclosures* was issued in October 2002.

Since then, IPSAS 20 has been amended by the following IPSASs:

- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 20

Paragraph Affected	How Affected	Affected By
4	Amended	IPSAS 37 January 2015
15	Amended	IPSAS 37 January 2015
24	Amended	IPSAS 35 January 2015 Improvements to IPSASs November 2010
33	Amended	IPSAS 35 January 2015
42A	New	IPSAS 33 Janaury 2015
42B	New	IPSAS 37 January 2015 IPSAS 35 January 2015
43	Amended	IPSAS 33 January 2015

October 2002

IPSAS 20—RELATED PARTY DISCLOSURES

CONTENTS

International Public Sector Accounting Standard 20, *Related Party Disclosures*, is set out in the objective and paragraphs 1–43. All the paragraphs have equal authority. IPSAS 20 should be read in the context of its objective, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

The objective of this Standard is to require the disclosure of the existence of related party relationships where control exists, and the disclosure of information about transactions between the entity and its related parties in certain circumstances. This information is required for accountability purposes, and to facilitate a better understanding of the financial position and performance of the reporting entity. The principal issues in disclosing information about related parties are (a) identifying which parties control or significantly influence the reporting entity, and (b) determining what information should be disclosed about transactions with those parties.

Scope

1. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in disclosing information about related party relationships and certain transactions with related parties.**

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 Government Business Enterprises (GBEs) apply IFRSs issued by the 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:**

   Close members of the family of an individual are close relatives of the individual or members of the individual's immediate family who can be expected to influence, or be influenced by, that individual in their dealings with the entity.

   Key management personnel are:

   (a) **All directors or members of the governing body of the entity; and**

   (b) **Other persons having the authority and responsibility for planning, directing, and controlling the activities of the reporting entity. Where they meet this requirement, key management personnel include:**

      (i) **Where there is a member of the governing body of a whole-of-government entity who has the authority and**

responsibility for planning, directing, and controlling the activities of the reporting entity, that member;

(ii) **Any key advisors of that member; and**

(iii) **Unless already included in (a), the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity.**

Oversight means the supervision of the activities of an entity, with the authority and responsibility to control, or exercise significant influence over, the financial and operating decisions of the entity.

Related party means parties are considered to be related if one party has the ability to (a) control the other party, or (b) exercise significant influence over the other party in making financial and operating decisions, or if the related party entity and another entity are subject to common control. Related parties include:

(a) **Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity;**

(b) **Associates (see IPSAS 36, *Investments in Associates and Joint Ventures*);**

(c) **Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;**

(d) **Key management personnel, and close members of the family of key management personnel; and**

(e) **Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.**

Related party transaction is a transfer of resources or obligations between related parties, regardless of whether a price is charged. Related party transactions exclude transactions with any other entity that is a related party solely because of its economic dependence on the reporting entity or the government of which it forms part.

Remuneration of key management personnel is any consideration or benefit derived directly or indirectly by key management personnel from the reporting entity for services provided in their capacity as members of the governing body, or otherwise as employees of the reporting entity.

Significant influence (for the purpose of this Standard) is the power to participate in the financial and operating policy decisions of an entity,

but not control those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for example, participation in (a) the policy making process, (b) material transactions between entities within an economic entity, (c) interchange of managerial personnel, or (d) dependence on technical information. Significant influence may be gained by an ownership interest, statute, or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in IPSAS 36.

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

Close Member of the Family of an Individual

5. Judgment will be necessary in determining whether an individual should be identified as a close member of the family of an individual for purposes of application of this Standard. In the absence of information to the contrary, such as that a spouse or other relative is estranged from the individual, the following immediate family members and close relatives are presumed to have, or be subject to, such influence as to satisfy the definition of close members of the family of an individual:

    (a) A spouse, domestic partner, dependent child, or relative living in a common household;

    (b) A grandparent, parent, nondependent child, grandchild, brother, or sister; and

    (c) The spouse or domestic partner of a child, a parent-in-law, a brother-in-law, or a sister-in-law.

Key Management Personnel

6. Key management personnel include all directors or members of the governing body of the reporting entity, where that body has the authority and responsibility for planning, directing, and controlling the activities of the entity. At the whole-of-government level, the governing body may consist of elected or appointed representatives (for example, a president or governor, ministers, councilors and aldermen or their nominees).

7. Where an entity is subject to the oversight of an elected or appointed representative of the governing body of the government to which the entity belongs, that person is included in key management personnel, if the oversight function includes the authority and responsibility for planning, directing, and controlling the activities of the entity. In many jurisdictions, key advisors of that person may not possess sufficient authority, legal or otherwise, to satisfy the definition of key management personnel. In other

jurisdictions, key advisors of that person may be deemed to be key management personnel because they have a special working relationship with an individual who has control over an entity. They therefore have access to privileged information, and may also be able to exercise control or significant influence over an entity. Judgment is required in assessing whether an individual is a key advisor, and whether that advisor satisfies the definition of key management personnel, or is a related party.

8. The governing body, together with the chief executive and senior management group, has the authority and responsibility to plan and control the activities of the entity, to manage the resources of the entity and for the overall achievement of entity objectives. Therefore, key management personnel will include the chief executive and senior management group of the reporting entity. In some jurisdictions, civil servants will not have sufficient authority and responsibility to qualify as key management personnel (as defined by this Standard) of the whole-of-government reporting entity. In these cases, key management personnel will consist only of those elected members of the governing body who have the greatest responsibility for the government; often these persons are referred to as Cabinet Ministers.

9. The senior management group of an economic entity may comprise individuals from both the controlling entity and other entities that collectively make up the economic entity.

Related Parties

10. In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

11. Where two entities have a member of key management personnel in common, it is necessary to consider the possibility, and to assess the likelihood, that this person would be able to affect the policies of both entities in their mutual dealings. However, the mere fact that there is a member of key management personnel in common does not necessarily create a related party relationship.

12. In the context of this Standard, the following are deemed not to be related parties:

    (a) (i) Providers of finance in the course of their business in that regard; and

    (ii) Trade unions;

    in the course of their normal dealings with an entity by virtue only of those dealings (although they may circumscribe the freedom of action of an entity or participate in its decision-making process); and

(b) An entity with which the relationship is solely that of an agency.

13. Related party relationships may arise when an individual is either a member of the governing body or is involved in the financial and operating decisions of the reporting entity. Related party relationships may also arise through external operating relationships between the reporting entity and the related party. Such relationships will often involve a degree of economic dependency.

14. Economic dependency, where one entity is dependent on another in that it relies on the latter for a significant volume of its funding or sale of its goods and services, would on its own be unlikely to lead to control or significant influence and is therefore unlikely to give rise to a related party relationship. As such, a single customer, supplier, franchisor, distributor, or general agent with whom a public sector entity transacts a significant volume of business will not be a related party merely by virtue of the resulting economic dependency. However, economic dependency, together with other factors, may give rise to significant influence, and therefore a related party relationship. Judgment is required in assessing the impact of economic dependence on a relationship. Where the reporting entity is economically dependent on another entity, the reporting entity is encouraged to disclose the existence of that dependency.

15. The definition of related party includes entities owned by key management personnel, close family members of such individuals or major shareholders (or equivalent where the entity does not have a formal equity structure) of the reporting entity. The definition of related party also includes circumstances in which one party has the ability to exercise significant influence over the other party. In the public sector, an individual or entity may be given oversight responsibility for a reporting entity, which gives them significant influence, but not control, over the financial and operating decisions of the reporting entity. For the purposes of this Standard, significant influence is defined to encompass joint ventures.

Remuneration of Key Management Personnel

16. Remuneration of key management personnel includes remuneration derived by individuals from the reporting entity for services provided to the reporting entity in their capacity as members of the governing body or employees. Benefits derived directly or indirectly from the entity for services in any capacity, other than as an employee or a member of the governing body, do not satisfy the definition of remuneration of key management personnel in this Standard. However, paragraph 34 requires disclosures to be made about certain of these other benefits. Remuneration of key management personnel excludes any consideration provided solely as a reimbursement for expenditure incurred by those individuals for the

benefit of the reporting entity, such as the reimbursement of accommodation costs associated with work-related travel.

Voting Power

17. The definition of related party will include any individuals owning, directly or indirectly, an interest in the voting power of the reporting entity that gives them significant influence over the entity. The holding of an interest in the voting power of an entity can arise when a public sector entity has a corporate structure, and a minister or government agency holds shares in the entity.

The Related Party Issue

18. Related party relationships exist throughout the public sector, because:

    (a) Administrative units are subject to the overall direction of the executive government and, ultimately, the Parliament or similar body of elected or appointed officials, and operate together to achieve the policies of the government;

    (b) Government departments and agencies frequently conduct activities necessary for the achievement of different components of their responsibilities and objectives through separate controlled entities, and through entities over which they have significant influence; and

    (c) Ministers or other elected or appointed members of the government and senior management group can exert significant influence over the operations of a department or agency.

19. Disclosure of certain related party relationships and related party transactions and the relationship underlying those transactions is necessary for accountability purposes, and enables users to better understand the financial statements of the reporting entity because:

    (a) Related party relationships can influence the way in which an entity operates with other entities in achieving its individual objectives, and the way in which it co-operates with other entities in achieving common or collective objectives;

    (b) Related party relationships might expose an entity to risks, or provide opportunities that would not have existed in the absence of the relationship; and

    (c) Related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties. This occurs frequently in government departments and agencies, where goods and services are transferred between departments at less than full cost recovery as a part of normal operating procedures consistent with the achievement of the objectives of the reporting entity and the government. Governments and individual public sector entities are expected to use resources efficiently, effectively, and in the manner intended, and to deal with public monies with the highest levels of integrity. The existence of related party relationships means that one party can control or significantly influence the activities of another party. This provides the opportunity for transactions to occur on a basis that may advantage one party inappropriately at the expense of another.

20. Disclosure of certain types of related party transactions that occur, and the terms and conditions on which they were conducted, allows users to assess the impact of those transactions on the financial position and performance of an entity, and its ability to deliver agreed services. This disclosure also ensures that the entity is transparent about its dealings with related parties.

Remuneration of Key Management Personnel

21. Key management personnel hold positions of responsibility within an entity. They are responsible for the strategic direction and operational management of an entity, and are entrusted with significant authority. Their salaries are often established by statute, or an independent tribunal or other body independent of the reporting entity. However, their responsibilities may enable them to influence the benefits of office that flow to them or their related parties. This Standard requires certain disclosures to be made about (a) the remuneration of key management personnel and close members of the family of key management personnel during the reporting period, (b) loans made to them, and (c) the consideration provided to them for services they provide to the entity other than as a member of the governing body or an employee. The disclosures required by this Standard will ensure that appropriate minimum levels of transparency are applied to the remuneration of key management personnel and close members of the family of key management personnel.

Materiality

22. IPSAS 1 requires the separate disclosure of material items. The materiality of an item is determined with reference to the nature or size of that item. When assessing the materiality of related party transactions, the nature of the relationship between the reporting entity and the related party, and the nature of the transaction, may mean that a transaction is material regardless of its size.

Disclosure

23. In many countries, the laws and other authoritative financial reporting rules require financial statements of private sector entities and government

business enterprises to disclose information about certain categories of related parties and related party transactions. In particular, attention is focused on the entity's transactions with its directors or members of its governing body and with its senior management group, especially their remuneration and borrowings. This is (a) because of the fiduciary responsibilities of directors, members of the governing body, and senior management group, and (b) because they have extensive powers over the deployment of entity resources. In some jurisdictions, similar requirements are included in the statutes and regulations applicable to public sector entities.

24. Some IPSASs also require disclosure of transactions with related parties. For example, IPSAS 1 requires disclosure of amounts payable to and receivable from controlling entities, fellow controlled entities, associates, and other related parties. IPSAS 38, *Disclosure of Interests in Other Entities*, requires an entity to disclose information that enables users of its consolidated financial statements to understand the composition of the economic entity and information about each joint arrangement and associate that is material to the reporting entity.

Disclosure of Control

25. **Related party relationships where control exists shall be disclosed, irrespective of whether there have been transactions between the related parties.**

26. In order for a reader of financial statements to form a view about the effects of related party relationships on a reporting entity, it is appropriate to disclose related party relationships where control exists, irrespective of whether there have been transactions between the related parties. This would involve the disclosure of the names of any controlled entities, the name of the immediate controlling entity, and the name of the ultimate controlling entity, if any.

Disclosure of Related Party Transactions

27. **In respect of transactions between related parties, other than transactions that would occur within a normal supplier or client/recipient relationship on terms and conditions no more or less favorable than those which it is reasonable to expect the entity would have adopted if dealing with that individual or entity at arm's length in the same circumstances, the reporting entity shall disclose:**

    (a) **The nature of the related party relationships;**

    (b) **The types of transactions that have occurred; and**

    (c) **The elements of the transactions necessary to clarify the significance of these transactions to its operations and sufficient**

to enable the financial statements to provide relevant and reliable information for decision making and accountability purposes.

28. The following are examples of situations where related party transactions may lead to disclosures by a reporting entity:

(a) Rendering or receiving of services;

(b) Purchases or transfers/sales of goods (finished or unfinished);

(c) Purchases or transfers/sales of property and other assets;

(d) Agency arrangements;

(e) Leasing arrangements;

(f) Transfer of research and development;

(g) License agreements;

(h) Finance (including loans, capital contributions, grants whether in cash or in kind, and other financial support, including cost-sharing arrangements); and

(i) Guarantees and collaterals.

29. Public sector entities transact extensively with each other on a daily basis. These transactions may occur at cost, less than cost or free of charge. For example, a government department of administrative services may provide office accommodation free of charge to other departments, or a public sector entity may act as a purchasing agent for other public sector entities. In some models of government, there may be the capacity for recovery of more than the full cost of service delivery. Departments are related parties because they are subject to common control, and these transactions meet the definition of related party transactions. However, disclosure of information about transactions between these entities is not required where the transactions (a) are consistent with normal operating relationships between the entities, and (b) are undertaken on terms and conditions that are normal for such transactions in these circumstances. The exclusion of these related party transactions from the disclosure requirements of paragraph 27 reflects that public sector entities operate together to achieve common objectives, and acknowledges that different mechanisms may be adopted for the delivery of services by public sector entities in different jurisdictions. This Standard requires disclosures of related party transactions only when those transactions occur other than in accordance with the operating parameters established in that jurisdiction.

30. The information about related party transactions that would need to be disclosed to meet the objectives of general purpose financial reporting would normally include:

(a) A description of the nature of the relationship with related parties involved in these transactions, for example, whether the relationship was one of a controlling entity, a controlled entity, an entity under common control, or key management personnel;

(b) A description of the related party transactions within each broad class of transaction and an indication of the volume of the classes, either as a specific monetary amount or as a proportion of that class of transactions and/or balances;

(c) A summary of the broad terms and conditions of transactions with related parties, including disclosure of how these terms and conditions differ from those normally associated with similar transactions with unrelated parties; and

(d) Amounts or appropriate proportions of outstanding items.

31. Paragraph 34 of this Standard requires additional disclosures to be made about certain transactions between an entity and key management personnel and/or the close members of the family of key management personnel.

32. **Items of a similar nature may be disclosed in aggregate, except when separate disclosure is necessary to provide relevant and reliable information for decision-making and accountability purposes.**

33. Disclosure of related party transactions between members of an economic entity is unnecessary in consolidated financial statements, because consolidated financial statements present information about the controlling entity and controlled entities as a single reporting entity. Related party transactions that occur between entities within an economic entity, except for those between an investment entity and its controlled entities measured at fair value through surplus or deficit, are eliminated on consolidation in accordance with IPSAS 35, *Consolidated Financial Statements*. Transactions with associated entities accounted for under the equity method are not eliminated, and therefore require separate disclosure as related party transactions.

Disclosure—Key Management Personnel

34. **An entity shall disclose:**

(a) **The aggregate remuneration of key management personnel and the number of individuals, determined on a full-time equivalent basis, receiving remuneration within this category, showing separately major classes of key management personnel and including a description of each class;**

(b) **The total amount of all other remuneration and compensation provided to key management personnel, and close members of**

the family of key management personnel, by the reporting entity during the reporting period, showing separately the aggregate amounts provided to:

(i) **Key management personnel; and**

(ii) **Close members of the family of key management personnel; and**

(c) **In respect of loans that are not widely available to persons who are not key management personnel and loans whose availability is not widely known by members of the public, for each individual member of key management personnel and each close member of the family of key management personnel:**

(i) **The amount of loans advanced during the period and terms and conditions thereof;**

(ii) **The amount of loans repaid during the period;**

(iii) **The amount of the closing balance of all loans and receivables; and**

(iv) **Where the individual is not a director or member of the governing body or senior management group of the entity, the relationship of the individual to such body or group.**

35. Paragraph 27 of this Standard requires the disclosure of related party transactions that have occurred other than on an arm's length basis consistent with the operating conditions established for the entity. This Standard also requires the disclosure of information about certain transactions with key management personnel identified in paragraph 34, whether or not they have occurred on an arm's length basis consistent with the operating conditions that apply in respect of the entity.

36. Persons who are key management personnel may be employed on a full- or part-time basis. The number of individuals disclosed as receiving remuneration in accordance with paragraph 34(a) needs to be estimated on a full-time equivalent basis. Entities will make separate disclosures about the major classes of key management personnel that they have. For example, where an entity has a governing body that is separate from its senior management group, disclosures about remuneration of the two groups will be made separately. Where an individual is a member of both the governing body and the senior management group, that individual will be included in only one of those groups for the purposes of this Standard. The categories of key management personnel identified in the definition of key management personnel provide a guide to identifying classes of key management personnel.

37. Remuneration of key management personnel can include a variety of direct and indirect benefits. Where the cost of these benefits is determinable, that cost will be included in the aggregate remuneration disclosed. Where the cost of these benefits is not determinable, a best estimate of the cost to the reporting entity or entities will be made and included in the aggregate remuneration disclosed.

38. Requirements on the measurement of employee benefits are found in IPSAS 25, *Employee Benefits*. When non-monetary remuneration that is able to be reliably measured has been included in the aggregate amount of remuneration of key management personnel disclosed for the period, disclosure would also be made in the notes to the financial statements of the basis of measurement of the non-monetary remuneration.

39. This Standard requires the disclosure of certain information about the terms and conditions of loans made to key management personnel and close members of the family of key management personnel, where these loans:

    (a) Are not widely available to persons outside the key management group; and

    (b) May be widely available outside the key management group, but whose availability is not widely known to members of the public.

    The disclosure of this information is required for accountability purposes. The exercise of judgment may be necessary in determining which loans should be disclosed to satisfy the requirements of this Standard. That judgment should be exercised after consideration of the relevant facts, and in a manner consistent with the achievement of the objectives of financial reporting.

40. Paragraph 34(a) of this Standard requires disclosure of the aggregate remuneration of key management personnel. Key management personnel include directors or members of the governing body and members of the senior management group of the entity. Directors or members of the governing body of the entity may also receive remuneration or compensation from the entity for services provided in a capacity other than (a) as director or member of the governing body of the entity, or (b) as an employee of the entity. Paragraph 34(b)(i) of this Standard requires the disclosure of the total amount of this other remuneration or compensation.

41. Close members of the family of key management personnel may influence, or be influenced by, key management personnel in their transactions with the reporting entity. Paragraph 34(b)(ii) of this Standard requires the disclosure of the total remuneration and compensation provided during the period to close members of the family of key management personnel.

Effective Date

42. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2004. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2004, it shall disclose that fact.**

42A. **Paragraph 43 was amended by IPSAS 33,** ***First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)*** **issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.**

42B. **IPSAS 35,** ***Consolidated Financial Statements*** **IPSAS 37,** ***Joint Arrangements*** **and IPSAS 38,** ***Disclosure of Interests in Other Entities,*** **issued in January 2015, amended paragraphs 4, 15, 24 and 33. An entity shall apply those amendments when it applies IPSAS 35, IPSAS 37, and IPSAS 38.**

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

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 20.

Disclosure—Government X

The following disclosures are made in the financial statements of Government X.

Controlled Entities (Paragraph 25)

The Government controls the following reporting entities:

Government Departments and Agencies: Education, Welfare, Police, Post, Works and Services, Defense, Justice, Treasury/Finance, Department X, Agency XYZ (identify all departments and agencies).

Government Business Enterprises: Government Electricity Company, Government Telecommunications Agency (identify all GBEs).

(Note: IPSAS 35, requires that certain disclosures be made about significant controlled entities.)

Related Party Transactions (Paragraph 27)

A member of Cabinet was provided with a house, rent free, in the national Capital City. Houses similar to that provided to the Minister rent for approximately Z currency units per annum. The provision of accommodation is not part of the remuneration package of the Minister, and the Government does not generally provide free accommodation to ministers. However, in this case it was necessary to provide a residence for the Minister in the Capital City.

The partner of another member of Cabinet was provided with a motor vehicle, rent free. Cars similar to that provided normally rent for K currency units per annum. The government does not generally provide motor vehicles, rent free, to the domestic partners of ministers.

Key Management Personnel (Paragraph 34)

Remuneration (Paragraph 34(a))

The key management personnel (as defined by IPSAS 20, *Related Party Disclosures*) are the members of Cabinet, who together constitute the governing body of Government X. The aggregate remuneration of members of the Cabinet and the number of individuals determined on a full-time equivalent basis receiving remuneration from Government X are:

Aggregate remuneration	X million.
Number of persons	Y persons.

Loans That are not Widely Available (and/or Widely Known) to Persons Outside the Key Management Group (paragraph 34(c))

Amounts of such loans advanced and repaid during the period, and the balances outstanding at the end of the period, are outlined below:

Individual	Advanced	Repaid	Balance
The Honorable ABC	J	K	L
Ms. VSL	M	N	P
The Honorable D	Q	R	Z
The Honorable E	S	T	U

Terms and Conditions

The Honorable ABC, Minister of Transport, received a loan at X% per annum, which is Y% below the market rate. The term of the loan is for Z years.

Ms. VSL, partner of the Minister of Health, received a government loan. The loan is for N years at X% per annum, the current government borrowing rate.

The salary packages of Cabinet Ministers the Honorable D and E allow them to take out a government loan for up to A years at Y% per annum to purchase a car.

Other Remuneration and Compensation Provided to Key Management Personnel and their Close Family Members (paragraph 34(b))

During the reporting period, total compensation of X amount (currency units) was provided to members of the Cabinet for consulting services provided to particular government agencies.

During the reporting period, the government provided total remuneration and compensation of Y amount (currency units) to close family members of key management personnel. This amount consists of the remuneration of government employees who are close members of the family of members of the Cabinet.

Disclosure—Government Agency XYZ

These disclosures are made in the financial statements of Government Agency XYZ, which is a separate reporting entity.

Controlled Entities (Paragraph 25)

The Agency is controlled by Department X. Department X is controlled by Government X.

The Agency controls the Administration Services Unit, which is a government business enterprise (GBE).

(Note: IPSAS 35, requires that certain disclosures be made about significant controlled entities.)

Related Party Transactions (Paragraph 27)

The Agency provided a house, rent free, to the Minister. Houses similar to that provided to the Minister rent for approximately Z currency units per annum. The house is not part of the remuneration package of the Minister and, as a matter of operating procedure, government agencies do not provide residential accommodation to ministers. However, Government X advised that the house should be provided on this occasion.

Key Management Personnel (Paragraph 34)

Remuneration (Paragraph 34(a))

The key management personnel (as defined by IPSAS 20) of Agency XYZ are the Minister, the members of the governing body, and the members of the senior management group. The governing body consists of members appointed by Government X; the chief executive officer and the chief financial officer attend meetings of the governing body but are not members of the governing body. The Minister is not remunerated by Agency XYZ. The aggregate remuneration of members of the governing body and the number of members determined on a full-time equivalent basis receiving remuneration within this category, are:

Aggregate remuneration	AX million.
Number of persons	AY persons.

The senior management group consists of the Agency's chief executive officer, the chief financial officer, and the AZ heads of division. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category are:

Aggregate remuneration	AP million.
Number of persons	AQ persons.

Two division heads are on secondment from Department X, and are remunerated by Department X.

Loans That are not Widely Available (and/or Widely Known) to Persons Outside the Key Management Group (paragraph 34(c))

Amounts advanced and repaid during the period and balance outstanding at the end of the period:

Individual	Advanced	Repaid	Balance
The Minister	J	K	L
Mr. G	M	N	P
Ms. H	Q	R	Z

Terms and Conditions

The Minister received a loan of J currency units, at X% per annum, which is Y% below the market rate. The term of the loan is for Z years.

The salary package of senior staff members, Mr. G and Ms. H, allows them to take out a government loan for up to N years at Y% per annum to purchase a car.

Remuneration and Compensation Provided to Close Family Members of Key Management Personnel (paragraph 34(b))

During the reporting period, total remuneration and compensation of F amount (currency units) was provided by the Agency to employees who are close family members of key management personnel.

Comparison with IAS 24

IPSAS 20 is drawn primarily from IAS 24 (Reformatted 1994). The main differences between IPSAS 20 and IAS 24 are as follows:

- The structure of IPSAS 20 differs substantially from that of IAS 24.
- The exclusion from the scope of IAS 24 of wholly-owned subsidiaries where the parent entity is domiciled in the same country and provides consolidated financial statements in that country has not been adopted in IPSAS 20.
- Commentary that identifies key management personnel in IAS 24 has been included in a formal definition of "key management personnel" in IPSAS 20. The commentary in IAS 24 includes close members of the family; the definition of "key management personnel" in IPSAS 20 does not include close members of the family.
- The definition of "related party" in IPSAS 20 includes related party relationships that are only noted in commentary in IAS 24.
- IPSAS 20 includes a definition of "remuneration of key management personnel." IAS 24 does not include this definition.
- IPSAS 20 contains additional disclosure requirements in relation to (a) the remuneration of key management personnel and their close family members, and (b) certain other transactions between an entity and its key management personnel and their close family members.
- Commentary additional to that in IAS 24 has been included in IPSAS 20 to clarify the applicability of the standards to accounting by public sector entities.
- Except for limited disclosures about the remuneration of, and certain other specified transactions with, key management personnel, IPSAS 20 does not require the disclosure of information about transactions between related parties that occur on normal terms and conditions. IAS 24 has more limited exclusions for related party transactions that occur in the course of normal dealings between the parties.
- IPSAS 20 uses different terminology, in certain instances, from IAS 24. The most significant example is the use of the terms "members of the governing body" in IPSAS 20. The equivalent term in IAS 24 is "directors."

IPSAS 21—IMPAIRMENT OF NON-CASH-GENERATING ASSETS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 36 (2004), *Impairment of Assets*, published by the International Accounting Standards Board (IASB). Extracts from IAS 36 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 21—IMPAIRMENT OF NON-CASH-GENERATING ASSETS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 21, *Impairment of Non-Cash-Generating Assets* was issued in December 2004.

Since then, IPSAS 21 has been amended by the following IPSASs:

- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- IPSAS 26, *Impairment of Cash-Generating Assets* (issued February 2008)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)
- IPSAS 31, *Intangible Assets* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 21

Paragraph Affected	How Affected	Affected By
2	Amended	IPSAS 29 January 2010 IPSAS 31 January 2010
5	Amended	IPSAS 26 February 2008
6	Amended	IPSAS 26 February 2008
7	Amended	IPSAS 31 January 2010
9	Amended	IPSAS 29 January 2010
12	Amended	Improvements to IPSASs November 2010
13	Amended	IPSAS 37 January 2015 IPSAS 35 January 2015
14	Amended	IPSAS 26 February 2008

Paragraph Affected	How Affected	Affected By
16[1]	Amended	IPSAS 26 February 2008
17	New	IPSAS 26 February 2008
18	New	IPSAS 26 February 2008
19	New	IPSAS 26 February 2008
20	New	IPSAS 26 February 2008
20	Amended	Improvements to IPSASs November 2010
26A	New	IPSAS 31 January 2010
26B	New	IPSAS 31 January 2010
27	Amended	Improvements to IPSASs October 2011
39A	New	IPSAS 31 January 2010
71	Amended	IPSAS 26 February 2008
72	New	IPSAS 26 February 2008
72A	New	IPSAS 26 February 2008
73A	New	Improvements to IPSASs November 2010
73A	Deleted	Editorials April 2012
80	Deleted	IPSAS 33 January 2015
80A	New	Improvements to IPSASs October 2011
81	Deleted	IPSAS 33 January 2015
82A	New	IPSAS 31 January 2010
82B	New	Improvements to IPSASs October 2011
82C	New	IPSAS 33 January 2015
82D	New	IPSAS 37 January 2015 IPSAS 35 January 2015

[1] Subsequent paragraphs have been renumbered.

Paragraph Affected	How Affected	Affected By
83	Amended	IPSAS 33 January 2015

December 2004

IPSAS 21—IMPAIRMENT OF NON-CASH-GENERATING ASSETS

CONTENTS

Illustrative Examples

Comparison with IAS 36 (2004)

International Public Sector Accounting Standard 21, *Impairment of Non-Cash-Generating Assets*, is set out in paragraphs 1–83. All the paragraphs have equal authority. IPSAS 21 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the procedures that an entity applies to determine whether a non-cash-generating asset is impaired, and to ensure that impairment losses are recognized. This Standard also specifies when an entity would reverse an impairment loss, and prescribes disclosures.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for impairment of non-cash-generating assets, except:**

   (a) **Inventories (see IPSAS 12, *Inventories*);**

   (b) **Assets arising from construction contracts (see IPSAS 11, *Construction Contracts*);**

   (c) **Financial assets that are included in the scope of IPSAS 29, *Financial Instruments: Recognition and Measurement*;**

   (d) **Investment property that is measured using the fair value model (see IPSAS 16, *Investment Property*);**

   (e) **Non-cash-generating property, plant, and equipment that is measured at revalued amounts (see IPSAS 17, *Property, Plant, and Equipment*);**

   (f) **Non-cash-generating intangible assets that are measured at revalued amounts (see IPSAS 31, *Intangible Assets*); and**

   (g) **Other assets in respect of which accounting requirements for impairment are included in another IPSAS.**

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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

5. **Public sector entities that hold cash-generating assets as defined in paragraph 14, shall apply IPSAS 26, *Impairment of Cash-Generating Assets*, to such assets. Public sector entities that hold non-cash-generating assets shall apply the requirements of this Standard to non-cash-generating assets.**

6. This Standard excludes from its scope the impairment of assets that are dealt with in another IPSAS. GBEs apply IAS 36, and therefore are not subject to

the provisions of this Standard. Public sector entities other than GBEs apply IPSAS 26 to their cash-generating assets, and apply this Standard to their non-cash-generating assets. Paragraphs 6–13 explain the scope of the Standard in greater detail.

7. This Standard excludes non-cash-generating intangible assets that are regularly revalued to fair value from its scope. This Standard includes all other non-cash-generating intangible assets (e.g., those that are carried at cost less any accumulated amortization) within its scope. Entities apply the requirements of this Standard to recognizing and measuring impairment losses, and reversals of impairment losses, related to such non-cash-generating intangible assets.

8. This Standard does not apply to inventories and assets arising from construction contracts, because existing IPSASs applicable to these assets contain requirements for recognizing and measuring these assets.

9. This Standard does not apply to financial assets that are included in the scope of IPSAS 28, *Financial Instruments: Presentation*. Impairment of these assets is dealt with in IPSAS 29.

10. This Standard does not require the application of an impairment test to an investment property that is carried at fair value in accordance with IPSAS 16. This is because, under the fair value model in IPSAS 16, an investment property is carried at fair value at the reporting date and any impairment will be taken into account in the valuation.

11. This Standard does not require the application of an impairment test to non-cash-generating assets that are carried at revalued amounts under the allowed alternative treatment in IPSAS 17. This is because, under the allowed alternative treatment in IPSAS 17, (a) assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date, and (b) any impairment will be taken into account in the valuation. In addition, the approach adopted in this Standard to measuring an asset's recoverable service amount means that it is unlikely that the recoverable service amount of an asset will be materially less than an asset's revalued amount, and that any such differences would relate to the costs of disposal of the asset.

12. Consistent with the requirements of paragraph 5 above, items of property, plant, and equipment that are classified as cash-generating assets, including those that are carried at revalued amounts under the allowed alternative treatment in IPSAS 17, are dealt with under IPSAS 26.

13. Investments in:

    (a) Controlled entities, as defined in IPSAS 35, *Consolidated Financial Statements*;

(b) Associates, as defined in IPSAS 36, *Investments in Associates and Joint Ventures*; and

(c) Joint arrangements, as defined in IPSAS 37, *Joint Arrangements*;

are financial assets that are excluded from the scope of IPSAS 29. Where such investments are classified as cash-generating assets, they are dealt with under IPSAS 26. Where these assets are non-cash-generating assets, they are dealt with under this Standard.

Definitions

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

An <u>active market</u> is a market in which all the following conditions exist:

(a) **The items traded within the market are homogeneous;**

(b) **Willing buyers and sellers can normally be found at any time; and**

(c) **Prices are available to the public.**

<u>Cash-generating assets</u> are assets held with the primary objective of generating a commercial return.

<u>Costs of disposal</u> are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

<u>Fair value less costs to sell</u> is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

An <u>impairment</u> is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.

<u>Non-cash-generating assets</u> are assets other than cash-generating assets.

<u>Recoverable service amount</u> is the higher of a non-cash-generating asset's fair value less costs to sell and its value in use.

<u>Useful life</u> is either:

(a) **The period of time over which an asset is expected to be used by the entity; or**

(b) **The number of production or similar units expected to be obtained from the asset by the entity.**

Value in use of a non-cash-generating asset is the present value of the asset's remaining service potential.

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

Government Business Enterprises

15. 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.

Cash-Generating Assets

16. Cash-generating assets are assets held with the primary objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Holding an asset to generate a commercial return indicates that an entity intends to generate positive cash inflows from the asset (or from the cash-generating unit of which the asset is a part), and earn a commercial return that reflects the risk involved in holding the asset. An asset may be held with the primary objective of generating a commercial return, even though it does not meet that objective during a particular reporting period. Conversely, an asset may be a non-cash-generating asset, even though it may be breaking even or generating a commercial return during a particular reporting period. Unless stated otherwise, references to an asset or assets in the following paragraphs of this Standard are references to non-cash-generating asset(s).

17. There are a number of circumstances in which public sector entities may hold some assets with the primary objective of generating a commercial return, although the majority of assets are not held for that purpose. For example, a hospital may deploy a building for fee-paying patients. Cash-generating assets of a public sector entity may operate independently of the non-cash-generating assets of the entity. For example, the deeds office may earn land registration fees independently from the department of land affairs.

18. In certain instances, an asset may generate cash flows although it is primarily held for service delivery purposes. For example, a waste disposal plant is operated to ensure the safe disposal of medical waste generated by state-controlled hospitals, but the plant also treats a small amount of medical waste generated by other private hospitals on a commercial basis. The

treatment of medical waste from the private hospitals is incidental to the activities of the plant, and the assets that generate cash flows cannot be distinguished from the non-cash-generating assets.

19. In other instances, an asset may generate cash flows and also be used for non-cash-generating purposes. For example, a public hospital has ten wards, nine of which are used for fee-paying patients on a commercial basis, and the other is used for non-fee-paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 26. If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies IPSAS 26 rather than this Standard.

20. In some cases, it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases, it is necessary to evaluate the significance of the cash flows. It may be difficult to determine whether the extent to which the asset generates cash flows is so significant that this Standard is applicable rather than IPSAS 26. Judgment is needed to determine which Standard to apply. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets, and with the related guidance in paragraphs 16–20. Paragraph 73A requires an entity to disclose the criteria used in making this judgment. However, given the overall objectives of most public sector entities, other than GBEs, the presumption is that assets are non-cash-generating and, therefore, IPSAS 21 will apply.

21. Assets held by GBEs are cash-generating assets. Public sector entities other than GBEs may hold assets to generate a commercial return. For the purposes of this Standard, an asset held by a non-GBE public sector entity is classified as a cash-generating asset if the asset (or unit of which the asset is a part) is operated with the objective of generating a commercial return through the provision of goods and/or services to external parties.

Depreciation

22. Depreciation and amortization are the systematic allocation of the depreciable amount of an asset over its useful life. In the case of an intangible asset, the term amortization is generally used instead of depreciation. Both terms have the same meaning.

Impairment

23. This Standard defines an impairment as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset’s future economic benefits or service

potential through depreciation (amortization). Impairment, therefore, reflects a decline in the utility of an asset to the entity that controls it. For example, an entity may have a purpose-built military storage facility that it no longer uses. In addition, because of the specialized nature of the facility and its location, it is unlikely that it can be leased out or sold, and therefore the entity is unable to generate cash flows from leasing or disposing of the asset. The asset is regarded as impaired, as it is no longer capable of providing the entity with service potential – it has little, or no, utility for the entity in contributing to the achievement of its objectives.

Identifying an Asset that may be Impaired

24. Paragraphs 26–34 specify when recoverable service amounts would be determined.

25. A non-cash-generating asset is impaired when the carrying amount of the asset exceeds its recoverable service amount. Paragraph 27 identifies key indications that an impairment loss may have occurred. If any of those indications are present, an entity is required to make a formal estimate of recoverable service amount. If no indication of a potential impairment loss is present, this Standard does not require an entity to make a formal estimate of recoverable service amount.

26. **An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable service amount of the asset.**

26A. **Irrespective of whether there is any indication of impairment, an entity shall also test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable service amount. This impairment test may be performed at any time during the reporting period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognized during the current reporting period, that intangible asset shall be tested for impairment before the end of the current reporting period.**

26B. The ability of an intangible asset to generate sufficient future economic benefits or service potential to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

27. **In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:**

External sources of information

(a) **Cessation, or near cessation, of the demand or need for services provided by the asset;**

(b) **Significant long-term changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, legal, or government policy environment in which the entity operates;**

Internal sources of information

(c) **Evidence is available of physical damage of an asset;**

(d) **Significant long-term changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, 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;**

(e) **A decision to halt the construction of the asset before it is complete or in a usable condition; and**

(f) **Evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, significantly worse than expected.**

28. The demand or need for services may fluctuate over time, which will affect the extent to which non-cash-generating assets are utilized in providing those services, but negative fluctuations in demand are not necessarily indications of impairment. Where demand for services ceases, or nearly ceases, the assets used to provide those services may be impaired. Demand may be considered to have nearly ceased when it is so low that the entity (a) would not have attempted to respond to that demand, or (b) would have responded by not acquiring the asset being considered for impairment testing.

29. The list in paragraph 27 is not exhaustive. There may be other indications that an asset may be impaired. The existence of other indications may result in the entity estimating the asset's recoverable service amount. For example, any of the following may be an indication of impairment:

(a) During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use; or

(b) A significant long-term decline (but not necessarily cessation or near cessation) in the demand for or need for services provided by the asset.

30. The events or circumstances that may indicate an impairment of an asset will be significant, and will often have prompted discussion by the governing board, management, or media. A change in a parameter such as demand for the service, extent or manner of use, legal environment, or government policy environment would indicate impairment only if such a change was significant, and had or was anticipated to have a long-term adverse effect. A change in the technological environment may indicate that an asset is obsolete, and requires testing for impairment. A change in the use of an asset during the period may also be an indication of impairment. This may occur when, for example, a building used as a school undergoes a change in use and is used for storage. In assessing whether an impairment has occurred, the entity needs to assess changes in service potential over the long term. This underlines the fact that the changes are seen within the context of the anticipated long-term use of the asset. However, the expectations of long-term use can change, and the entity's assessments at each reporting date would reflect that. The Implementation Guidance sets out examples of impairment indications referred to in paragraph 27.

31. In assessing whether a halt in construction would trigger an impairment test, the entity would consider (a) whether construction has simply been delayed or postponed, (b) whether there is an intention to resume construction in the near future, or (c) whether the construction work will not be completed in the foreseeable future. Where construction is delayed or postponed to a specific future date, the project may be treated as work-in-progress and is not considered as halted.

32. Evidence from internal reporting that indicates that an asset may be impaired, as referred to in paragraph 27(f) above, relates to the ability of the asset to provide goods or services rather than to a decline in the demand for the goods or services provided by the asset. This includes the existence of:

(a) Significantly higher costs of operating or maintaining the asset, compared with those originally budgeted; and

(b) Significantly lower service or output levels provided by the asset, compared with those originally expected due to poor operating performance.

A significant increase in operating costs of an asset may indicate that the asset is not as efficient or productive as initially anticipated in output standards set by the manufacturer, in accordance with which the operating budget was drawn up. Similarly, a significant increase in maintenance costs may indicate that higher costs need to be incurred to maintain the asset's performance at a level indicated by its most recently assessed standard of performance. In other cases, direct quantitative evidence of an impairment may be indicated by a significant long-term fall in the expected service or output levels provided by the asset.

33. The concept of materiality applies in identifying whether the recoverable service amount of an asset needs to be estimated. For example, if previous assessments show that an asset's recoverable service amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable service amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable service amount is not sensitive to one (or more) of the indications listed in paragraph 27.

34. If there is an indication that an asset may be impaired, this may indicate that (a) the remaining useful life, (b) the depreciation (amortization) method, or (c) the residual value for the asset needs to be reviewed and adjusted in accordance with the IPSAS applicable to the asset, even if no impairment loss is recognized for the asset.

Measuring Recoverable Service Amount

35. This Standard defines recoverable service amount as the higher of an asset's fair value, less costs to sell, and its value in use. Paragraphs 36–50 set out the basis for measuring recoverable service amount.

36. It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired, and it is not necessary to estimate the other amount.

37. It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. Paragraph 42 sets out possible alternative bases for estimating fair value less costs to sell when an active market for the asset does not exist. However, sometimes it will not be possible to determine fair value less costs to sell, because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value in use as its recoverable service amount.

38. If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable service amount. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds. However, for many public sector non-cash-generating assets that are held on an ongoing basis to provide specialized services or public goods to the

community, the value in use of the asset is likely to be greater than its fair value less costs to sell.

39. In some cases, estimates, averages, and computational short cuts may provide reasonable approximations of the detailed computations illustrated in this Standard for determining fair value less costs to sell or value in use.

Measuring the Recoverable Service Amount of an Intangible Asset with an Indefinite Useful Life

39A. Paragraph 26A requires an intangible asset with an indefinite useful life to be tested for impairment annually by comparing its carrying amount with its recoverable service amount, irrespective of whether there is any indication that it may be impaired. However, the most recent detailed calculation of such an asset's recoverable service amount made in a preceding period may be used in the impairment test for that asset in the current period, provided all of the following criteria are met:

(a) If the intangible asset does not provide service potential from continuing use that is largely independent of those from other assets or groups of assets and is therefore tested for impairment as part of the cash-generating unit to which it belongs, the assets and liabilities making up that unit have not changed significantly since the most recent recoverable amount calculation;

(b) The most recent recoverable service amount calculation resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and

(c) Based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable service amount calculation, the likelihood that a current recoverable service amount determination would be less than the asset's carrying amount is remote.

Fair Value Less Costs to Sell

40. The best evidence of an asset's fair value less costs to sell is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.

41. If there is no binding sale agreement, but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, provided that there has not been a significant change in economic

circumstances between the transaction date and the date as at which the estimate is made.

42. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity could consider the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale, unless management or the governing body is compelled to sell immediately.

43. Costs of disposal, other than those that have been recognized as liabilities, are deducted in determining fair value less costs to sell. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits (as defined in IPSAS 25, *Employee Benefits*,) and costs associated with reducing or reorganizing a business following the disposal of an asset, are not direct incremental costs to dispose of the asset.

Value in Use

44. This Standard defines the value in use of a non-cash-generating asset as the present value of the asset's remaining service potential. Value in use in this Standard refers to value in use of a non-cash-generating asset, unless otherwise specified. The present value of the remaining service potential of the asset is determined using any one of the approaches identified in paragraphs 45–49, as appropriate.

Depreciated Replacement Cost Approach

45. Under this approach, the present value of the remaining service potential of an asset is determined as the depreciated replacement cost of the asset. The replacement cost of an asset is the cost to replace the asset's gross service potential. This cost is depreciated to reflect the asset in its used condition. An asset may be replaced either through reproduction (replication) of the existing asset or through replacement of its gross service potential. The depreciated replacement cost is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost, to reflect the already consumed or expired service potential of the asset.

46. The replacement cost and reproduction cost of an asset are determined on an optimized basis. The rationale is that the entity would not replace or reproduce the asset with a like asset if the asset to be replaced or reproduced is an overdesigned or overcapacity asset. Overdesigned assets contain

features that are unnecessary for the goods or services the asset provides. Overcapacity assets are assets that have a greater capacity than is necessary to meet the demand for goods or services the asset provides. The determination of the replacement cost or reproduction cost of an asset on an optimized basis thus reflects the service potential required of the asset.

47. In certain cases, standby or surplus capacity is held for safety or other reasons. This arises from the need to ensure that adequate service capacity is available in the particular circumstances of the entity. For example, the fire department needs to have fire engines on standby to deliver services in emergencies. Such surplus or standby capacity is part of the required service potential of the asset.

Restoration Cost Approach

48. Restoration cost is the cost of restoring the service potential of an asset to its pre-impaired level. Under this approach, the present value of the remaining service potential of the asset is determined by subtracting the estimated restoration cost of the asset from the current cost of replacing the remaining service potential of the asset before impairment. The latter cost is usually determined as the depreciated reproduction or replacement cost of the asset, whichever is lower. Paragraphs 45 and 47 include additional guidance on determining the replacement cost or reproduction cost of an asset.

Service Units Approach

49. Under this approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the restoration cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower.

Application of Approaches

50. The choice of the most appropriate approach to measuring value in use depends on the availability of data and the nature of the impairment:

    (a) Impairments identified from significant long-term changes in the technological, legal, or government policy environment are generally measurable using a depreciated replacement cost approach or a service units approach, when appropriate;

    (b) Impairments identified from a significant long-term change in the extent or manner of use, including that identified from the cessation or near cessation of demand, are generally measurable using a depreciated replacement cost or a service units approach, when appropriate; and

(c) Impairments identified from physical damage are generally measurable using a restoration cost approach or a depreciated replacement cost approach, when appropriate.

Recognizing and Measuring an Impairment Loss

51. Paragraphs 52–57 set out the requirements for recognizing and measuring impairment losses for an asset. In this Standard, impairment loss refers to impairment loss of a non-cash-generating asset unless otherwise specified.

52. **If, and only if, the recoverable service amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable service amount. That reduction is an impairment loss.**

53. As noted in paragraph 26, this Standard requires an entity to make a formal estimate of recoverable service amount only if an indication of a potential impairment loss is present. Paragraphs 27–33 identify key indications that an impairment loss may have occurred.

54. **An impairment loss shall be recognized immediately in surplus or deficit.**

55. **When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognize a liability if, and only if, that is required by another IPSAS.**

56. Where the estimated impairment loss is greater than the carrying amount of the asset, the carrying amount of the asset is reduced to zero, with a corresponding amount recognized in surplus or deficit. A liability would be recognized only if another IPSAS so requires. An example is when a purpose-built military installation is no longer used and the entity is required by law to remove such installations if not usable. The entity may need to make a provision for dismantling costs if required by IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

57. **After the recognition of an impairment loss, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Reversing an Impairment Loss

58. Paragraphs 59–70 set out the requirements for reversing an impairment loss recognized for an asset in prior periods.

59. **An entity shall assess at each reporting date whether there is any indication that an impairment loss recognized in prior periods for an**

asset may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable service amount of that asset.

60. **In assessing whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:**

External sources of information

(a) **Resurgence of the demand or need for services provided by the asset;**

(b) **Significant long-term changes with a favorable effect on the entity have taken place during the period, or will take place in the near future, in the technological, legal, or government policy environment in which the entity operates;**

Internal sources of information

(c) **Significant long-term changes with a favorable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance an asset's performance or restructure the operation to which the asset belongs;**

(d) **A decision to resume construction of the asset that was previously halted before it was completed or in a usable condition; and**

(e) **Evidence is available from internal reporting that indicates that the service performance of the asset is, or will be, significantly better than expected.**

61. Indications of a potential decrease in an impairment loss in paragraph 60 mainly mirror the indications of a potential impairment loss in paragraph 27.

62. The list in paragraph 60 is not exhaustive. An entity may identify other indications of a reversal of an impairment loss that would also require the entity to re-estimate the asset's recoverable service amount. For example, either of the following may be an indication that the impairment loss may have reversed:

(a) A significant rise in an asset's market value; or

(b) A significant long-term increase in the demand or need for the services provided by the asset.

63. A commitment to discontinue or restructure an operation in the near future is an indication of a reversal of an impairment loss of an asset belonging to the operation, where such a commitment constitutes a significant long-term change, with a favorable effect on the entity, in the extent or manner of use of that asset. Circumstances where such a commitment would be an indication of reversal of impairment often relate to cases where the expected discontinuance or restructuring of the operation would create opportunities to enhance the utilization of the asset. An example is an x-ray machine that has been underutilized by a clinic managed by a public hospital and, as a result of restructuring, is expected to be transferred to the main radiology department of the hospital where it will have significantly better utilization. In such a case, the commitment to discontinue or restructure the clinic's operation may be an indication that an impairment loss recognized for the asset in prior periods may have to be reversed.

64. If there is an indication that an impairment loss recognized for an asset may no longer exist or may have decreased, this may indicate that (a) the remaining useful life, (b) the depreciation (amortization) method, or (c) the residual value may need to be reviewed and adjusted in accordance with the IPSAS applicable to the asset, even if no impairment loss is reversed for the asset.

65. **An impairment loss recognized in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable service amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset shall, except as described in paragraph 68, be increased to its recoverable service amount. That increase is a reversal of an impairment loss.**

66. This Standard requires an entity to make a formal estimate of recoverable service amount only if an indication of a reversal of an impairment loss is present. Paragraph 60 identifies key indications that an impairment loss recognized for an asset in prior periods may no longer exist or may have decreased.

67. A reversal of an impairment loss reflects an increase in the estimated recoverable service amount of an asset, either from use or from sale, since the date when an entity last recognized an impairment loss for that asset. Paragraph 77 requires an entity to identify the change in estimates that causes the increase in recoverable service amount. Examples of changes in estimates include:

    (a) A change in the basis for recoverable service amount (i.e., whether recoverable service amount is based on fair value less costs to sell or value in use);

(b) If recoverable service amount was based on value in use, a change in estimate of the components of value in use; or

(c) If recoverable service amount was based on fair value less costs to sell, a change in estimate of the components of fair value less costs to sell.

68. **The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of depreciation or amortization) if no impairment loss had been recognized for the asset in prior periods.**

69. **A reversal of an impairment loss for an asset shall be recognized immediately in surplus or deficit.**

70. **After a reversal of an impairment loss is recognized, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Redesignation of Assets

71. **The redesignation of assets from cash-generating assets to non-cash-generating assets or from non-cash-generating assets to cash-generating assets shall only occur when there is clear evidence that such a redesignation is appropriate. A redesignation, by itself, does not necessarily trigger an impairment test or a reversal of an impairment loss. Instead, the indication for an impairment test or a reversal of an impairment loss arises from, as a minimum, the listed indications applicable to the asset after redesignation.**

72. There are circumstances in which public sector entities may decide that it is appropriate to redesignate a non-cash-generating asset as a cash-generating asset. For example, an effluent treatment plant was constructed primarily to treat industrial effluent from a social housing unit, for which no charge is made. The social housing unit has been demolished, and the site will be developed for industrial and retail purposes. It is intended that, in future, the plant will be used to treat industrial effluent at commercial rates. In light of this decision, the public sector entity decides to redesignate the effluent treatment plant as a cash-generating asset.

Disclosure

72A. **An entity shall disclose the criteria developed by the entity to distinguish non-cash-generating assets from cash-generating assets.**

73. **An entity shall disclose the following for each class of assets:**

(a) **The amount of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of**

financial performance in which those impairment losses are included; and

(b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of financial performance in which those impairment losses are reversed.**

73A. [Deleted]

74. A class of assets is a grouping of assets of similar nature and use in an entity's operations.

75. The information required in paragraph 73 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant, and equipment, at the beginning and end of the period, as required by IPSAS 17.

76. **An entity that reports segment information in accordance with IPSAS 18, *Segment Reporting*, shall disclose the following for each segment reported by the entity:**

(a) **The amount of impairment losses recognized in surplus or deficit during the period; and**

(b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period.**

77. **An entity shall disclose the following for each material impairment loss recognized or reversed during the period:**

(a) **The events and circumstances that led to the recognition or reversal of the impairment loss;**

(b) **The amount of the impairment loss recognized or reversed;**

(c) **The nature of the asset;**

(d) **The segment to which the asset belongs, if the entity reports segment information in accordance with IPSAS 18;**

(e) **Whether the recoverable service amount of the asset is its fair value less costs to sell or its value in use;**

(f) **If the recoverable service amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market); and**

(g) **If the recoverable service amount is value in use, the approach used to determine value in use.**

78. **An entity shall disclose the following information for the aggregate of impairment losses and aggregate reversals of impairment losses recognized during the period for which no information is disclosed in accordance with paragraph 77:**

    (a) **The main classes of assets affected by impairment losses (and the main classes of assets affected by reversals of impairment losses); and**

    (b) **The main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.**

79. An entity is encouraged to disclose key assumptions used to determine the recoverable service amount of assets during the period.

Transitional Provisions

80. [Deleted]

80A. **The amendment to paragraph 27 shall be applied prospectively from the date of its application.**

81. [Deleted]

Effective Date

82. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2006. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2006, it shall disclose that fact.**

82A. **IPSAS 31 amended paragraphs 2 and 7, and inserted paragraphs 26A, 26B, and 39A. An entity shall apply those amendments for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies IPSAS 31 for a period beginning before April 1, 2011, the amendments shall also be applied for that earlier period.**

82B. **Paragraph 27 was amended by *Improvements to IPSASs 2011* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2013, it shall disclose that fact.**

82C. **Paragraphs 80, 81 and 83 were amended by *IPSAS 33, First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted.**

If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.

82D. **IPSAS 35, *Consolidated Financial Statements*, and IPSAS 37, *Joint Arrangements* issued in January 2015, amended paragraph 13. An entity shall apply those amendments when it applies IPSAS 35 and IPSAS 37.**

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

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 21.

Introduction

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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. The accrual IPSASs are based on the IFRSs issued by the IASB, to the extent that the requirements of those Standards are applicable to the public sector. The requirements of this Standard have been developed consistent with that policy. IAS 36 requires entities to determine the recoverable amount of an asset if there are indications that the asset is impaired. The recoverable amount of an asset is defined as the higher of value in use and fair value less costs to sell of the asset. This Standard includes a similar definition.

BC3. IAS 36 applies to cash-generating assets and cash-generating units, while this Standard applies to individual non-cash-generating assets. This results in a number of differences between the two standards. The main differences are:

(a) The method of measurement of value in use of a non-cash-generating asset under this Standard is different from that applied to a cash-generating asset under IAS 36;

(b) This Standard does not require entities to apply an impairment test to property, plant, and equipment carried at revalued amounts; and

(c) This Standard does not include a decrease in market value significantly greater than would be expected as a result of the passage of time or normal use as a minimum indication of impairment. This indication is included as an additional indication that impairment may exist.

The IPSASB's reasons for making these departures from the requirements of IAS 36 are explained in the paragraphs below.

BC4. An Invitation to Comment (ITC), *Impairment of Assets*, issued in 2000 proposed an approach to accounting for impairment of the assets of public sector entities that applied IAS 36 to the extent that it was appropriate. ED 23, *Impairment of Assets*, was developed after consideration of responses to the ITC and issued in 2003. This Standard was developed after consideration of the responses to ED 23.

Cash-Generating Assets

BC5. IAS 36 requires an entity to determine value in use as the present value of estimated future cash flows expected to be derived (a) from the continuing use of the asset, or cash-generating unit, and (b) from its disposal at the end of its useful life. The service potential of cash-generating assets is reflected by their ability to generate future cash flows. IPSAS 26 is based on IAS 36. The requirements of IPSAS 26 are applicable to cash-generating assets held by public sector entities. This Standard requires entities to apply IPSAS 26 to account for impairment of cash-generating assets in the public sector.

Non-Cash-Generating Assets

BC6. In considering the principles underpinning a value in use concept applicable to non-cash-generating assets, the IPSASB agreed that the value in use of a non-cash-generating asset should be measured by reference to the present value of the remaining service potential of the asset. This replicates the approach taken by IAS 36.

Determination of Value in Use

BC7. Determining value in use (present value of remaining service potential) of a non-cash-generating asset may be approached in a number of ways. One approach that replicates IAS 36 involves estimating and discounting cash inflows that would have arisen had the entity sold its services or other outputs in the market. However, the IPSASB is of the view that it is unlikely that this approach could be used in practice, due to the complexities involved in determining the appropriate prices at which to value the service or other output units and estimating the appropriate discount rate.

BC8. Other approaches reflect an implicit determination of value in use. In this respect, the IPSASB considered the market value approach, and approaches that measure depreciated replacement cost, and include consideration of restoration cost and service units.

Market value approach

BC9. Under this approach, where an active market exists for the asset, the value in use of the non-cash-generating asset is measured at the observable market value of the asset. Where an active market for the asset is not available, the entity uses the best available market evidence of the price at which the asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction, having regard to the highest and best use of the asset for which market participants would be prepared to pay in the prevailing circumstances. The IPSASB noted that the use of the observable market value as a proxy for value in use was redundant, since market value differed from the fair value less costs to sell (the other arm of the recoverable service amount estimate) of the asset only by the amount of the costs of disposal. Therefore the market value would be effectively captured by the fair value less costs to sell arm of recoverable service amount.

Depreciated replacement cost approach

BC10. Under this approach, the value in use of the asset is determined as the lowest cost at which the gross service potential embodied in the asset could be obtained in the normal course of operations, less the value of the service potential already consumed. This approach assumes that the entity replaces the remaining service potential of the asset if it is deprived of it. An asset may be replaced either through reproduction (such as specialized assets) or through replacement of its gross service potential. Therefore, value in use is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired service potential of the asset.

Restoration cost approach

BC11. This approach is usually used when impairment losses arise from damage. Under this approach, the value in use of the asset is determined by subtracting the estimated restoration cost of the asset from the depreciated replacement or reproduction cost of the asset before impairment.

Service units approach

BC12. This approach determines the value in use of the asset by reducing the depreciated replacement or reproduction cost of the asset before impairment to conform to the reduced number of service units expected from the asset in its impaired state.

Approaches adopted

BC13. The IPSASB agreed that the value in use of a non-cash-generating asset will be measured using the depreciated replacement cost, the restoration cost, or the service units approaches cited above as appropriate.

Other Assets

BC14. IPSAS 21 contains specific requirements for testing intangible assets for impairment, and for recognizing and measuring impairment losses related to intangible assets. These requirements complement the requirements of IPSAS 31, *Intangible Assets*. Non-cash-generating intangible assets measured at cost are included in the scope of this Standard and should be tested for impairment according to the requirements of this Standard.

Group of Assets and Corporate Assets

BC15. Under IAS 36, where it is not possible to determine the recoverable amount for an individual asset, then the recoverable amount for the asset's cash-generating unit (CGU) will be determined. The CGU is the smallest identifiable group of assets (a) that generates cash inflows from continuing use, and (b) that is largely independent of the cash inflows from other assets or groups of assets. The IPSASB considered the concept of a service-generating unit in a non-cash-generating context. It noted that as the requirements in this Standard are applied to individual assets, the adoption of such a concept by analogy to the CGU concept in IAS 36 is unnecessary, because it is possible to identify the service potential of individual assets. Moreover, its adoption would introduce undue complexities in accounting for impairment of non-cash-generating assets.

BC16. Under IAS 36, assets other than goodwill that contribute to the future cash flows of two or more CGUs are regarded as corporate assets. In a cash-generating context, because corporate assets do not generate separate cash inflows, the impairment of corporate assets are dealt with as part of the impairment of the cash-generating unit to which the corporate assets belong. The IPSASB observed that in a non-cash-generating context, the concept of a service-generating unit is not warranted, as noted in paragraph BC15 above. The IPSASB further noted that such assets are often an integral part of the service delivery function and their impairment is to be dealt with as for any other non-cash-generating assets of the entity.

Property, Plant, and Equipment and Intangible Assets

BC17. The Standard does not require the application of an impairment test to non-cash-generating assets that are carried at revalued amounts under the allowed alternative treatment ("revaluation model") in IPSAS 17 and IPSAS 31. The IPSASB is of the view that under the allowed alternative treatment in IPSAS 17 and IPSAS 31, assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value as at the reporting date, and any impairment will be taken into account in the valuation. Therefore any difference between the asset's carrying amount and its fair value less costs to sell will be the disposal costs. The IPSASB is of the view that, in most cases, these will not be material and, from a practical viewpoint, it is not necessary to measure an asset's recoverable service amount and to recognize an impairment loss for the disposal costs of a non-cash-generating asset.

BC18. In contrast to this Standard, IAS 36 requires entities to test revalued assets for impairment after they had been revalued. The rationale for this difference can be explained by reference to the factors set out in paragraphs BC19 and BC20 below.

BC19. Firstly, there are different methods of determining recoverable service amount under this Standard, and of determining recoverable amount under IAS 36. Recoverable service amount is defined in this Standard as the higher of a non-cash-generating asset's fair value less costs to sell and its value in use. Under this Standard, an entity determines an asset's value in use by determining the current cost to replace the asset's remaining service potential. The current cost to replace the asset's remaining service potential is determined using the depreciated replacement cost approach, and approaches described as the restoration cost approach and the service units approach. These approaches may also be adopted to measure fair value under IPSAS 17 and IPSAS 31 therefore the value in use is a measure of fair value. Recoverable amount is defined in IAS 36 as the higher of an asset's fair value less costs to sell and its value in use. Value in use under IAS 36 is determined using the present value of the cash flows expected to be derived from continued use of the asset and its eventual disposal. IAS 36 states that the value in use may be different from the fair value of the asset.

BC20. Secondly, the requirement under IAS 36 to combine non-cash-generating assets with cash-generating assets to form a cash-generating unit is not replicated in this Standard. Under IAS 36, where an asset does not produce cash inflows, it is combined with other assets to form a cash-generating unit, the value in use of which is then measured. The sum of the fair values of the assets that make up a cash-generating unit may be different to the value in use of the cash-generating unit.

Impairment of Non-Cash-Generating Assets Held by GBEs

BC21. This Standard requires that the impairment of all assets held by GBEs be accounted for under IAS 36. GBEs are profit-oriented entities, and the assets employed by them are primarily cash-generating assets. The *Preface to International Public Sector Accounting Standards* makes it clear that GBEs are profit-oriented entities, and are therefore required to comply with IFRSs and IASs. Individual IPSASs make it explicit that IFRSs apply to GBEs. Accordingly, non-cash-generating assets are expected to be appropriately grouped with cash-generating assets of GBEs to form a cash-generating unit to be tested for impairment in accordance with IAS 36.

Indications of Impairment—Changes in Market Value

BC22. IAS 36 includes as a minimum indication of impairment that an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use. The IPSASB has included this as an additional indication of impairment, but not as a minimum indication of impairment. The IPSASB is of the view that these changes in market value do not necessarily indicate that a non-cash-generating asset is impaired. This is because non-cash-generating assets are held for reasons other than generating a commercial return; therefore, a change in market value may not reflect a change in the amount of service that the entity will recover from continued use of the asset.

Reversal of Impairment

BC23. Paragraph 60(a) includes resurgence of demand or need for services provided by the asset as a minimum indication of reversal of impairment, while paragraph 62(b) includes a significant long-term increase in demand or need for the services provided by the asset as an additional indication of possible reversal of impairment. The wording of these two indications is similar; however, they can be distinguished from each other because paragraph 60(a) refers to a resurgence of the demand that had declined and resulted in the recognition of an impairment loss. Paragraph 62(b) refers to new demand, and may be unrelated to the reason an impairment loss was recognized in respect of the asset.

BC24. Paragraph 62(a) includes a significant rise in an asset's market value as an additional indication of reversal of impairment. This does not mirror the indication of impairment in paragraph 27(a), which requires that the decline in market value be significantly more than would be expected as a result of the passage of time or normal use. This difference means that the increase in market value may be expected or unexpected.

BC25. Paragraph 27(c) includes "Evidence is available of physical damage of an asset" as a minimum indication of impairment. Paragraph 60 does not include an indication of reversal of impairment that mirrors this indication of impairment. The IPSASB has not included repair of an asset as an indication of reversal, because IPSAS 17 requires entities to add subsequent expenditure to the carrying amount of an item of property, plant, and equipment when it is probable that future economic benefits or service potential over the total life of the asset, in excess of the most recently assessed standard of performance of the existing asset, will flow to the entity. This requirement also applies to investment property that is measured using the cost model under IPSAS 16. The IPSASB is of the view that these requirements negate the need for an indication of reversal of impairment that mirrors the physical damage indication of impairment. The IPSASB also noted that restoration or repair of damage does not constitute a change in the estimate of the asset's recoverable service amount after impairment as specified by paragraph 65 of this IPSAS.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 21.

Indications of Impairment (paragraph 27)

External Sources of Information

(a) **Cessation, or Near Cessation, of the Demand or Need for Services Provided by the Asset.**

IG1. The asset still maintains the same service potential, but demand for that service has ceased or nearly ceased. Examples of assets impaired in this manner include:

(a) A school closed because of a lack of demand for school services, arising from a population shift to other areas. It is not anticipated that this demographic trend affecting the demand for the school services will reverse in the foreseeable future;

(b) A school designed for 1,500 students currently has an enrollment of 150 students – the school cannot be closed because the nearest alternative school is 100 kilometers away. The entity does not envisage the enrollment increasing. At the time of establishment, enrollment was 1,400 students – the entity would have acquired a much smaller facility had future enrollment been envisaged to be 150 students. The entity determines that demand has nearly ceased, and the recoverable service amount of the school should be compared with its carrying amount;

(c) A railway line closed due to lack of patronage (for example, the population in a rural area has substantially moved to the city due to successive years of drought, and those that have stayed behind use the cheaper bus service); and

(d) A stadium whose principal occupant does not renew its occupancy agreement, with the result that the facility is expected to close.

(b) **Significant Long-Term Changes with an Adverse Effect on the Entity in the Technological, Legal, or Government Policy Environment in Which the Entity Operates.**

Technological Environment

IG2. The service utility of an asset may be reduced if technology has advanced to produce alternatives that provide better or more efficient service. Examples of assets impaired in this manner are:

(a) Medical diagnostic equipment that is rarely or never used because a newer machine embodying more advanced technology provides more accurate results (would also meet indication (a) above);

(b) Software that is no longer being supported by the external supplier because of technological advances, and the entity does not have the personnel to maintain the software; and

(c) Computer hardware that has become obsolete as the result of technological development.

Legal or Government Policy Environment

IG3. An asset's service potential may be reduced as a result of a change in a law or regulation. Examples of impairments identified by this indication include:

(a) An automobile that does not meet new emission standards or an airplane that does not meet new noise standards;

(b) A school that can no longer be used for instruction purposes due to new safety regulations regarding its building materials or emergency exits; and

(c) A drinking water plant that cannot be used because it does not meet new environmental standards.

Internal Sources of Information

(c) **Evidence is Available of Physical Damage of an Asset.**

IG4. Physical damage would likely result in the asset being unable to provide the level of service that it once was able to provide. Examples of assets impaired in this way include:

(a) A building damaged by fire or flood or other factors;

(b) A building that is closed due to identification of structural deficiencies;

(c) Sections of an elevated roadway that have sagged, indicating that these sections of roadway will need to be replaced in 15 years rather than the original design life of 30 years;

(d) A dam whose spillway has been reduced as a result of a structural assessment;

(e) A water treatment plant whose capacity has been reduced by an intake blockage, and the removal of the blockage is not economical;

(f) A bridge that is weight-restricted due to identification of structural deficiencies;

(g) A navy destroyer damaged in a collision; and

(h) Equipment that is damaged and can no longer be repaired, or for which repairs are not economically feasible.

(d) **Significant Long-Term Changes, with an Adverse Effect on the Entity, in the Extent to Which an Asset is Used, or is Expected to be Used.**

IG5. The asset still maintains the same service potential, but long-term changes have an adverse effect on the extent to which the asset is used. Examples of circumstances in which assets may be impaired in this manner include:

(a) If an asset is not being used to the same degree as it was when originally put into service, or the expected useful life of the asset is shorter than originally estimated, the asset may be impaired. An example of an asset that might be identified as potentially being impaired by this indication is a mainframe computer that is underutilized, because many applications have been converted or developed to operate on servers or PC platforms. A significant long-term decline in the demand for an asset's services may translate itself into a significant long-term change in the extent to which the asset is used; and

(b) If the asset is not being used in the same way as it was when originally put into service, the asset may be impaired. An example of an impaired asset that might be identified by this indication is a school building that is being used for storage rather than for educational purposes.

(e) **A decision to Halt the Construction of the Asset Before it is Complete or in a Usable Condition.**

IG6. An asset that will not be completed cannot provide the service intended. Examples of assets impaired in this manner include those where:

(a) Construction was stopped due to identification of an archaeological discovery or environmental condition, such as a nesting ground for a threatened or endangered species; or

(b) Construction was stopped due to a decline in the economy.

The circumstances that led to the halting of construction will also be considered. If construction is deferred, that is, postponed to a specific future date, the project could still be treated as work-in-progress, and is not considered as halted.

(f) **Evidence is Available from Internal Reporting that Indicates that the Service Performance of an Asset is, or will be, Significantly Worse than Expected.**

IG7. Internal reports may indicate that an asset is not performing as expected, or its performance is deteriorating over time. For example, an internal health department report on operations of a rural clinic may indicate that an x-ray machine used by the clinic is impaired because the cost of maintaining the machine has significantly exceeded that originally budgeted.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 21.

Measurement of Impairment Loss

Note: In the following examples, it is assumed that the fair value less costs to sell of the asset tested for impairment is less than its value in use or is not determinable, unless otherwise indicated. Therefore, the asset's recoverable service amount is equal to its value in use. In these examples, the straight-line method of depreciation is used.

Depreciated Replacement Cost Approach

Significant Long-term Change with Adverse Effect on the Entity in the Technological Environment—Underutilized Mainframe Computer

IE1. In 1999, the City of Kermann purchased a new mainframe computer at a cost of CU10 million.[2] Kermann estimated that the useful life of the computer would be seven years, and that on average 80 percent of central processing unit (CPU) capacity would be used by the various departments. A buffer of excess CPU time of 20 percent was expected and needed to accommodate scheduling jobs to meet peak period deadlines. Within a few months after acquisition, CPU usage reached 80 percent, but declined to 20 percent in 2003 because many applications of the departments were converted to run on desktop computers or servers. A computer is available on the market at a price of CU500,000 that can provide the remaining service potential of the mainframe computer using the remaining applications.

Evaluation of Impairment

IE2. The indication of impairment is the significant long-term change in the technological environment resulting in conversion of applications from the mainframe to other platforms, and therefore decreased usage of the mainframe computer. (Alternatively it can be argued that a significant decline in the extent of use of the mainframe indicates impairment.) Impairment loss is determined using the depreciated replacement cost approach as follows:

a	**Acquisition cost, 1999**	**10,000,000**
	Accumulated depreciation, 2003 (a × 4 ÷ 7)	**5,714,286**
b	**Carrying amount, 2003**	**4,285,714**
c	**Replacement cost**	**500,000**
	Accumulated depreciation(c × 4 ÷ 7)	**285,714**
d	**Recoverable Service Amount**	**214,286**

2 In these examples monetary amounts are denominated in "currency units" (CU).

	Impairment loss (b - d)	**4,071,428**

Near Cessation in Demand for the Services Provided by a Non-cash-Generating Asset—Underutilized Mainframe Software Application

IE3. In 1999, the City of Kermann purchased a software license for an application for its new mainframe computer for CU350,000. Kermann estimated that the useful life of the software would be seven years, and that it would receive economic benefits and service potential from the software on a straight-line basis over the life of the software. By 2003, usage of the application had declined to 15 percent of its originally anticipated demand. A license for a software application to replace the remaining service potential of the impaired software application costs CU70,000.

Evaluation of Impairment

IE4. The indication of impairment is technological change, brought about by the loss of mainframe computer capacity.

a	**Acquisition cost, 1999**	**350,000**
	Accumulated depreciation, 2003 (a × 4 ÷ 7)	**200,000**
b	**Carrying amount, 2003**	**150,000**
c	**Replacement cost**	**70,000**
	Accumulated amortization (c × 4 ÷ 7)	**40,000**
d	**Recoverable Service Amount**	**30,000**
	Impairment loss (b - d)	**120,000**

Significant Long-term Change with Adverse Effect on the Entity in the Manner of Use—School Used as Warehouse

IE5. In 1997, Lunden School District constructed an elementary school at a cost of CU10 million. The estimated useful life of the school is fifty years. In 2003, the school is closed because enrollments in the district declined unexpectedly due to a population shift caused by the bankruptcy of a major employer in the area. The school is converted to use as a storage warehouse, and Lunden School District has no expectation that enrollments will increase in the future such that the building would be reopened for use as a school. The current replacement cost for a warehouse with the same storage capacity as the school is CU4.2 million.

Evaluation of Impairment

IE6. Impairment is indicated, because the purpose for which the building is used has changed significantly from a place for instructing students to a storage facility, and this is not anticipated to change for the foreseeable future. An impairment loss using depreciated replacement cost approach would be determined as follows:

a	**Historical cost, 1997**	**10,000,000**
	Accumulated depreciation, 2003 (a × 6 ÷ 50)	**1,200,000**
b	**Carrying amount, 2003**	**8,800,000**
c	**Replacement cost of a storage facility of similar capacity**	**4,200,000**
	Accumulated depreciation (c × 6 ÷ 50)	**504,000**
d	**Recoverable Service Amount**	**3,696,000**
	Impairment loss (b - d)	**5,104,000**

Significant Long-term Change with Adverse Effect on the Entity in the Extent of Use—School Partially Closed Due to Decline in Enrollment

IE7. In 1983, the Lutton School District constructed a school at the cost of CU2.5 million. The entity estimated the school would be used for 40 years. In 2003, the enrollment declined from 1000 to 200 students as the result of population shift caused by the bankruptcy of a major employer in the area. The management decided to close the top two floors of the three-story school building. Lutton School District has no expectation that enrollments will increase in the future such that the upper stories would be reopened. The current replacement cost of the one-story school is estimated at CU1.3 million.

Evaluation of Impairment

IE8. Impairment is indicated because the extent of use of the school has changed from three floors to one floor as the result of a reduction in the number of students from 1000 to 200 students. The reduction in the extent of use is significant, and the enrollment is expected to remain at the reduced level for the foreseeable future. Impairment loss using a depreciated replacement cost approach would be determined as follows:

a	**Acquisition cost, 1983**	**2,500,000**
	Accumulated depreciation, 2003 (a × 20 ÷ 40)	**1,250,000**
b	**Carrying amount, 2003**	**1,250,000**
c	**Replacement cost**	**1,300,000**
	Accumulated depreciation (c × 20 ÷ 40)	**650,000**
d	**Recoverable Service Amount**	**650,000**
	Impairment loss (b - d)	**600,000**

Restoration Cost Approach

Physical Damage—School Bus Damaged in Road

IE9. In 1998, North District Primary School acquired a bus at the cost of CU200,000 to help students from a nearby village to commute free of charge. The school estimated a useful life of 10 years for the bus. In 2003, the bus sustained damage in a road accident, requiring CU40,000 to be restored to a usable condition. The restoration will not affect the useful life of the asset. The cost of a new bus to deliver a similar service is CU250,000 in 2003.

Evaluation of Impairment

IE10. Impairment is indicated because the bus has sustained physical damage in the road accident. Impairment loss using the restoration cost approach would be determined as follows:

a	**Acquisition cost, 1998**	**200,000**
	Accumulated depreciation, 2003 (a × 5 ÷ 10)	**100,000**
b	**Carrying amount, 2003**	**100,000**
c	**Replacement cost**	**250,000**
	Accumulated depreciation (c × 5 ÷ 10)	**125,000**
d	**Depreciated replacement cost (undamaged state)**	**125,000**
	Less: restoration cost	**40,000**
e	**Recoverable Service Amount**	**85,000**
	Impairment loss (b - e)	**15,000**

Physical Damage—Building damaged by fire

IE11. In 1984, the City of Moorland built an office building at a cost of CU50 million. The building was expected to provide service for 40 years. In 2003, after 19 years of use, fire caused severe structural problems. Due to safety reasons, the office building is closed, and structural repairs costing CU35.5 million are to be made to restore the office building to an occupiable condition. The replacement cost of a new office building is CU100 million.

Evaluation of Impairment

IE12. Impairment is indicated because the office building has sustained physical damage due to the fire. Impairment loss using a restoration cost approach would be determined as follows:

a	**Acquisition cost, 1984**	**50,000,000**
	Accumulated depreciation, 2003 (a × 19 ÷ 40)	**23,750,000**
b	**Carrying amount, 2003**	**26,250,000**

c	**Replacement cost (of a new building)**	**100,000,000**
d	**Accumulated depreciation (c × 19 ÷ 40)**	**47,500,000**
	Depreciated replacement cost (undamaged)	**52,500,000**
	Less: restoration cost	**35,500,000**
e	**Recoverable Service Amount**	**17,000,000**
	Impairment loss (b - e)	**9,250,000**

Service Units Approach

Significant Long-term Change with Adverse Effect on the Entity in the Extent of Use—High-rise Building Partially Unoccupied for the Foreseeable Future

IE13. In 1988, Ornong City Council constructed a 20-story office building for use by the Council in downtown Ornong at the cost of CU80 million. The building was expected to have a useful life of 40 years. In 2003, National Safety Regulations required that the top four stories of high rise buildings should be left unoccupied for the foreseeable future. The building has a fair value less costs to sell of CU45 million in 2003 after regulations came into force. The current replacement cost of a similar 20-story building is CU85 million.

Evaluation of Impairment

IE14. Impairment is indicated because the extent of use of the office building has changed from 20 floors to 16 floors as the result of new National Safety Regulations. The reduction in the extent of use is significant, and the occupation of the building is expected to remain at the reduced level (16 floors) for the foreseeable future. Impairment loss using the service units approach would be determined as follows:

a	**Acquisition cost, 1988**	**80,000,000**
	Accumulated depreciation, 2003 (a × 15 ÷ 40)	**30,000,000**
b	**Carrying amount, 2003**	**50,000,000**
c	**Replacement cost (20-story building)**	**85,000,000**
	Accumulated depreciation (c × 15 ÷ 40)	**31,875,000**
d	**Depreciated replacement cost before adjustment for remaining service units**	**53,125,000**
e	**Value in Use of the building after the regulation came into force**	
	(d × 16 ÷ 20)	**42,500,000**
f	**Fair value less costs to sell of the building after regulation came into force**	**45,000,000**
g	**Recoverable service amount (higher of e and f)**	**45,000,000**

	Impairment loss (b - g)	**5,000,000**

Evidence from Internal Reporting—Higher Cost of Operating the Printing Machine

IE15. In 1998, Country X Education Department purchased a new printing machine at a cost of CU40 million. The Department estimated that the useful life of the machine would be 40 million copies of books to be printed over 10 years for use by elementary school students. In 2003, it was reported that an automated feature of the machine's function does not operate as expected, resulting in a 25 percent reduction in the machine's annual output level over the remaining 5 years of the useful life of the asset. The replacement cost of a new printing machine is CU45 million in 2003.

Evaluation of Impairment

IE16. Impairment is indicated by evidence from internal reporting that the service performance of the printing machine is worse than expected. Circumstances suggest that the decline in the service potential of the asset is significant and of a long-term nature. Impairment loss using a service units approach is determined as follows:

a	**Acquisition cost, 1998**	**40,000,000**
	Accumulated depreciation (a × 5 ÷ 10)	**20,000,000**
b	**Carrying amount, 2003**	**20,000,000**
c	**Replacement cost**	**45,000,000**
	Accumulated depreciation (c × 5 ÷ 10)	**22,500,000**
d	**Depreciated replacement cost before adjustment for remaining service units**	**22,500,000**
e	**Recoverable Service Amount (d × 75%)**	**16,875,000**
	Impairment loss (b - e)	**3,125,000**

Comparison with IAS 36 (2004)

IPSAS 21 is drawn primarily from IAS 36 (2004). The main differences between IPSAS 21 and IAS 36 (2004) are as follows:

- IPSAS 21 deals with the impairment of non-cash-generating assets of public sector entities, while IAS 36 deals with the impairment of cash-generating assets of profit-oriented entities. IPSAS 26 deals with the impairment of cash-generating assets of public sector entities.
- IPSAS 21 does not apply to non-cash-generating assets carried at revalued amounts at the reporting date under the allowed alternative treatment in IPSAS 17. IAS 36 does not exclude from its scope cash-generating property, plant, and equipment carried at revalued amounts at the reporting date.
- The method of measurement of value in use of a non-cash-generating asset under IPSAS 21 is different from that applied to a cash-generating asset under IAS 36. IPSAS 21 measures the value in use of a non-cash-generating asset as the present value of the asset's remaining service potential using a number of approaches. IAS 36 measures the value in use of a cash-generating asset as the present value of future cash flows from the asset.
- IPSAS 21 does not include a change in the market value of the asset as a black letter indication of impairment. A significant, unexpected decline in market value appears in black letter in IAS 36 as part of the minimum set of indications of impairment while IPSAS 21 refers to it in commentary.
- IPSAS 21 includes a decision to halt the construction of an asset before completion as a black letter indication of impairment and the resumption of the construction of the asset as an indication of reversal of the impairment loss. There are no equivalents in IAS 36.
- The scope of IAS 36 excludes certain classes of assets that are not excluded from the scope of IPSAS 21. These exclusions relate to classes of assets that are the subject of specific impairment requirements under other IFRSs. These have not been excluded from IPSAS 21 because there are not equivalent IPSASs. These exclusions include (a) biological assets related to agricultural activity, (b) deferred tax assets, (c) deferred acquisition costs, (d) intangible assets arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4, *Insurance Contracts,* and (e) non-current assets (or disposal groups) classified as held for sale in accordance with IFRS 5, *Non-current Assets Held for Sale and Discontinued Operations*.

- IPSAS 21 deals with the impairment of individual assets. There is no equivalent in IPSAS 21 for a cash-generating unit as defined in IAS 36.
- IPSAS 21 deals with corporate assets in the same manner as other non-cash-generating assets, while IAS 36 deals with them as part of related cash-generating units.
- IPSAS 21 uses different terminology, in certain instances, from IAS 36. The most significant examples are the use of the terms “revenue,” “recoverable service amount”, and “statement of financial performance,” in IPSAS 21. The equivalent terms in IAS 36 are “income,” “recoverable amount,” and “income statement.”

IPSAS 22—DISCLOSURE OF FINANCIAL INFORMATION ABOUT THE GENERAL GOVERNMENT SECTOR

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 22, *Disclosure of Financial Information about the General Government Sector* was issued in December 2006.

Since then, IPSAS 22 has been amended by the following IPSASs:

- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 22

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
24	Amended	IPSAS 35 January 2015
26	Amended	IPSAS 35 January 2015
27	Amended	IPSAS 35 January 2015
29	Amended	IPSAS 35 January 2015
30	Amended	IPSAS 35 January 2015
41	Amended	IPSAS 35 January 2015
47A	New	IPSAS 33 Janaury 2015
47B	New	IPSAS 35 January 2015
48	Amended	IPSAS 33 Janaury 2015

December 2006

IPSAS 22—DISCLOSURE OF FINANCIAL INFORMATION ABOUT THE GENERAL GOVERNMENT SECTOR

CONTENTS

International Public Sector Accounting Standard 22, *Disclosure of Financial Information about the General Government Sector*, is set out in paragraphs 1–48. All the paragraphs have equal authority. IPSAS 22 should be read in the context of its objective, the Basis for Conclusions, the *Preface to the International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe disclosure requirements for governments that elect to present information about the general government sector (GGS) in their consolidated financial statements. The disclosure of appropriate information about the GGS of a government can enhance the transparency of financial reports, and provide for a better understanding of the relationship between the market and non-market activities of the government, and between financial statements and statistical bases of financial reporting.

Scope

2. **A government that prepares and presents consolidated financial statements under the accrual basis of accounting and elects to disclose financial information about the general government sector shall do so in accordance with the requirements of this Standard.**

3. Governments raise funds from taxes, transfers, and a range of nonmarket and market activities to fund their service delivery activities. They operate through a variety of entities to provide goods and services to their constituents. Some entities rely primarily on appropriations or allocations from taxes or other government revenues to fund their service delivery activities, but may also undertake additional revenue-generating activities, including commercial activities in some cases. Other entities may generate their funds primarily or substantially from commercial activities. These include government business enterprises (GBEs) as defined in IPSAS 1, *Presentation of Financial Statements*.

4. Financial statements for a government prepared in accordance with IPSASs provide an overview of (a) the assets controlled and liabilities incurred by the government, (b) the cost of services provided by the government, and (c) the taxation and other revenues generated to fund the provision of those services. Financial statements for a government, which delivers services through controlled entities, whether primarily dependent on the government budget to fund their activities or not, are consolidated financial statements.

5. In some jurisdictions, financial statements and budgets for the government, or sectors thereof, may also be issued in accordance with statistical bases of financial reporting. These bases reflect requirements consistent with, and derived from, the *System of National Accounts 1993* (SNA 93) prepared by the United Nations and other international organizations. These statistical bases of financial reporting focus on the provision of financial information about the GGS. The GGS comprises those non-profit entities that undertake nonmarket activities and rely primarily on appropriations or allocations from the government budget to fund their service delivery activities (hereafter referred to as nonmarket entities or activities). The statistical bases of

financial reporting may also provide information about (a) the corporations sector of government that primarily engages in market activities (usually characterized as the public financial corporations (PFC) sector and the public nonfinancial corporations (PNFC) sector), and (b) the public sector as a whole. The major features of the PFC and PNFC sectors are outlined at paragraphs 19 and 20 of this Standard.

6. Financial statements consolidate only controlled entities. Such a limitation is not made in statistical bases of financial reporting. In some jurisdictions, a national government controls state/provincial and local government entities, and therefore its financial statements consolidate those levels of government, but in other jurisdictions they do not. In all jurisdictions, under statistical bases of financial reporting, the GGS of all levels of government are combined, so in some jurisdictions the GGS will include units that financial statements do not consolidate. This Standard disaggregates the consolidated financial statements of a government. Therefore, it prohibits the presentation, as part of the GGS, of any entity not consolidated within a government's financial statements.

Segment Reporting

7. IPSAS 18, *Segment Reporting*, requires the disclosure of certain information about the service delivery activities of the entity and the resources allocated to support those activities for accountability and decision-making purposes. Unlike the sectors reported under statistical bases of financial reporting, segments reported in accordance with IPSAS 18 are not based on a distinction between market and nonmarket activities.

8. The disclosure of information about the GGS does not replace the need to make disclosures about segments in accordance with IPSAS 18. This is because information about the GGS alone will not provide sufficient detail to enable users to evaluate the entity's past performance in achieving major service delivery objectives, when those objectives are achieved through non-GGS entities. For example, identifying the GGS as a segment will not provide information about a government's performance in achieving its telecommunication, healthcare or educational objectives, where government corporations or quasi-corporations deliver services related to those objectives. Because the GGS is only a subset of the government as a whole, important information would be omitted if a government did not present segment information in respect of its consolidated financial statements.

Statistical Bases of Financial Reporting

9. The objectives of financial statements prepared in accordance with IPSASs and those prepared in accordance with statistical bases of financial reporting differ in some respects. The objectives of financial statements prepared in accordance with IPSASs are to provide information useful for decision

making, and to demonstrate the accountability of the entity for the resources entrusted to it and which it controls. The purpose of financial statements prepared in accordance with statistical bases of financial reporting is to provide information suitable for analyzing and evaluating fiscal policy, especially the performance of the GGS and the broader public sector of any country. In addition, although statistical bases of financial reporting may be described in accounting terms, they might differ in important ways from the underlying financial accounting system from which most of the statistics about government finances will be derived. However, the IPSASs and the statistical bases of financial reporting also have many similarities in the treatment of transactions and events. For example, they adopt an accrual basis of accounting, deal with similar transactions and events, and in some respects require a similar type of report structure.

10. In some jurisdictions, the disclosure of appropriate information about the GGS in financial statements can support and enhance the decision making of, and accountability to, users of those statements. For example, disclosure of information about the GGS is consistent with enhanced transparency of financial reporting, and will assist users of the financial statements to better understand:

(a) The resources allocated to support the service delivery activities by the GGS, and the government's financial performance in delivering those services; and

(b) The relationship between the GGS and the corporations sectors, and the impact each has on overall financial performance.

11. In those jurisdictions where financial statements for the government are prepared in accordance with statistical bases of financial reporting and widely published, the disclosure of information about the GGS in financial statements will form a useful link between the financial statements prepared in accordance with IPSASs and those prepared in accordance with statistical bases of financial reporting. This will assist users in reconciling information presented in financial statements to information presented in statistical reports. IPSAS 24, *Presentation of Budget Information in Financial Statements*, requires that financial statements include a comparison of budget and actual amounts on a basis consistent with that adopted for the budget. Where government budgets are prepared for the GGS rather than the government as a whole, financial information about the GGS disclosed in accordance with this Standard will be relevant to the comparisons required by that IPSAS.

Accounting Policies

12. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* requires the development of accounting policies to ensure that the financial

statements provide information that meets a number of qualitative characteristics. The compilation and presentation of GGS data that satisfy the qualitative characteristics of information provided in financial statements and related audit requirements may add significantly to the workload of preparers and auditors in many jurisdictions, and may increase the complexity of the financial statements. This will be particularly so in jurisdictions where financial statements based on, or incorporating, GGS disclosures in accordance with statistical bases of financial reporting are not currently prepared. In addition, in some jurisdictions, users may not be dependent on financial statements for information about the GGS. In those jurisdictions, the costs involved in preparing and presenting GGS disclosures as part of the financial statements may be greater than their benefit. Therefore, this Standard allows, but does not require, the disclosure of information about the GGS. Whether or not disclosure of information about the GGS will be made in financial statements will be determined by the government or other appropriate authority in each jurisdiction.

13. This Standard requires that when disclosures about the GGS are made in financial statements, those disclosures are to be made in accordance with the requirements prescribed in this Standard. This will ensure that an appropriate representation of the GGS is made in the financial statements, and that disclosures about the GGS satisfy the qualitative characteristics of financial information, including understandability, relevance, reliability, and comparability.

14. IPSASs generally apply to all public sector entities. However, it is only possible to disclose a meaningful representation of the GGS for a government – not its individual controlled entities. Therefore, this Standard specifies requirements for application only by governments that prepare consolidated financial statements under the accrual basis of accounting as prescribed by IPSASs. These governments may include national, state/provincial, and local governments.

Definitions

15. **The following term is used in this Standard with the meaning specified:**

The <u>General Government Sector</u> comprises all organizational entities of the general government as defined in statistical bases of financial reporting.

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

Government Business Enterprises (GBEs)

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.

General Government Sector

17. Under statistical bases of financial reporting, the public sector comprises the GGS, PFC, and PNFC sector. Additional subgroups within these sectors may be identified for statistical analytical purposes.

18. The GGS is defined in the SNA 93 (and updates) as consisting of (a) all resident central, state, and local government units, (b) social security funds at each level of government, and (c) nonmarket non-profit institutions controlled by government units. Under statistical bases of financial reporting, the GGS encompasses the central operations of government, and typically includes all those resident nonmarket non-profit entities that have their operations funded primarily by the government and government entities. As such, the financing of these entities is sourced primarily from appropriation or allocation of the government's taxes, dividends from government corporations, other revenues, and borrowings. The GGS typically includes entities such as government departments, law courts, public educational institutions, public health care units, and other government agencies. The GGS does not include PFCs or PNFCs. Disclosure of GGS information will be made in those jurisdictions where strengthening the link between IPSASs and statistical bases of financial reporting is considered useful and relevant to users of financial statements. Governments electing to make GGS disclosures will therefore need to ensure that the information about the GGS included in the financial statements is consistent with the definition of GGS, and any interpretations thereof, adopted for statistical bases of financial reporting in their jurisdiction.

Public Financial Corporations Sector

19. The PFC sector comprises resident government-controlled financial corporations, quasi-corporations, and non-profit institutions that primarily engage in financial intermediation and the provision of financial services for the market. Included within this sector are government-controlled banks, including central banks, and other government financial institutions that operate on a market basis.

Public Non-Financial Corporations Sector

20. The PNFC sector comprises resident government-controlled non-financial corporations, quasi-corporations, and non-profit institutions that produce goods or nonfinancial services for the market. Included within this sector are entities such as publicly owned utilities and other entities that trade in goods and services.

21. Statistical bases of financial reporting define:

    (a) Corporations as legal entities created for the purpose of producing goods and services for the market;

    (b) Quasi-corporations as enterprises that are not incorporated or otherwise legally established, but function as if they were corporations; and

    (c) Nonprofit institutions as legal or other entities that produce or distribute goods and services, but which do not generate financial gain for their controlling entity.

22. A GBE as defined in this Standard has similar characteristics to a public corporation or public quasi-corporation, as defined in statistical bases of financial reporting. However, there may not be an identical mapping of GBEs and the PFC and PNFC sectors. For example, a GBE that is not resident would not be classified as a PFC or a PNFC.

Accounting Policies

23. **Financial information about the GGS shall be disclosed in conformity with the accounting policies adopted for preparing and presenting the consolidated financial statements of the government, except as required by paragraphs 24 and 25.**

24. **In presenting financial information about the GGS, entities shall not apply the requirements of IPSAS 35, *Consolidated Financial Statements*, in respect of entities in the PFCs and public NFCS sectors.**

25. **The GGS shall recognize its investment in the PFC and public NFCS sectors as an asset, and shall account for that asset at the carrying amount of the net assets of its investees.**

26. This Standard reflects the view that the consolidated financial statements of a government that elects to disclose information about the GGS are to be disaggregated to present the GGS as one sector of the government reporting entity. Consistent with this view, this Standard requires that the same definitions and the same recognition, measurement, and presentation requirements that are applied when preparing the consolidated financial statements are also applied to the GGS disclosures, with one exception. That

exception is that the requirements of IPSAS 35 are not applied in respect of the relationship of the GGS sector with entities in the PFC and PNFC sectors.

27. IPSAS 35 requires controlling entities to prepare financial statements that consolidate controlled entities on a line-by-line basis. IPSAS 35 also contains (a) a detailed discussion of the concept of control as it applies in the public sector, and (b) guidance on determining whether control exists for financial reporting purposes. Consistent with the requirements of IPSAS 35, entities in the PFC and PNFC sectors, as defined in statistical bases of financial reporting, that are controlled entities of the government will be consolidated in the government's financial statements.

28. Financial statements prepared consistent with statistical bases of financial reporting portray the impact of the GGS on the public sector as a whole and, in the context of the SNA 93 (and updates), on a national economy. Consistent with that focus, statistical bases of financial reporting require the GGS financial statements to present public sector entities outside that sector as investments in other sectors. In addition, under statistical bases of financial reporting, transactions of the GGS with entities in other sectors are not eliminated from the statement of government operations or a similar statement.

29. To apply the IPSAS 35 requirements for consolidation to the GGS would result in the re-presentation of the consolidated financial statements of a government, rather than the GGS financial statements.

30. Therefore, in disclosing financial information about the GGS, balances and transactions between entities within the GGS are eliminated in accordance with IPSAS 35. However, balances and transactions between entities in the GGS and entities in other sectors are not eliminated.

31. This Standard requires the GGS sector to recognize its investment in entities in the PFC or PNFC sectors at the carrying amount of the net assets of those entities. This will ensure that the GGS disclosures reflect a disaggregation of financial information presented in the consolidated financial statements of the government of which it is a part. Consistent with the GGS being a disaggregation of the consolidated financial statements of a government, changes in the carrying amount of the net assets of those entities will be recognized in the same manner as they are recognized in the consolidated financial statements of a government.

32. Statistical bases of reporting require all assets and liabilities (except loans) to be revalued to market value at each reporting date. IPSASs include different measurement requirements, and require or permit cost and current values for certain classes of assets and liabilities. They do not require all assets and liabilities to be revalued to market value. Therefore, the measurement of assets and liabilities in the GGS disclosures in the financial statements,

including the investment in the PFC and PNFC sectors, may differ from the measurement basis adopted in statistical bases of reporting.

Further Disaggregation

33. In some jurisdictions, national governments may control provincial and/or local governments and, consequently, the national government's financial statements will consolidate different levels of government. If financial statements consolidate different levels of government, further disaggregation of the consolidated financial statements may occur in accordance with the requirements of this Standard to separately disclose information about the GGS at each level of government.

34. This further disaggregation is not required by this Standard. However, it may be presented to further assist users to better understand the relationship between the GGS activities of each level of government consolidated in the financial statements, and the relationship between financial statements and the statistical bases of financial reporting in those jurisdictions.

Disclosures

35. **Disclosures made in respect of the GGS shall include at least the following:**

    (a) **Assets by major class, showing separately the investment in other sectors;**

    (b) **Liabilities by major class;**

    (c) **Net assets/equity;**

    (d) **Total revaluation increments and decrements and other items of revenue and expense recognized directly in net assets/equity;**

    (e) **Revenue by major class;**

    (f) **Expenses by major class;**

    (g) **Surplus or deficit;**

    (h) **Cash flows from operating activities by major class;**

    (i) **Cash flows from investing activities; and**

    (j) **Cash flows from financing activities.**

    The manner of presentation of the GGS disclosures shall be no more prominent than the government's financial statements prepared in accordance with IPSASs.

36. IPSAS 1 identifies a complete set of financial statements (under the accrual basis) as a statement of financial position, statement of financial performance,

statement of changes in net assets/equity, cash flow statement, and accounting policies and notes to the financial statements.

37. This Standard requires disclosure of the major classes of assets, liabilities, revenues, expenses, and cash flows reflected in the financial statements. This Standard does not specify the manner in which the GGS disclosures shall be made. Governments electing to make GGS disclosures in accordance with this Standard may make such disclosures by way of (a) note disclosure, (b) separate columns in the primary financial statements, or (c) otherwise, as considered appropriate in their jurisdiction. However, the manner of presentation of the GGS disclosures will be no more prominent than the consolidated financial statements prepared in accordance with IPSASs.

38. To assist users to understand the relationship of financial information presented for the GGS to a government's operations, statistical bases of financial reporting require total government expenses to be disaggregated and disclosed by class, based on either the economic nature of the expenses or by the Classification of Functions of Government (COFOG). This Standard does not require nor prohibit entities disclosing GGS information from presenting disaggregated GGS information classified by economic nature or consistent with the COFOG classification basis. In some jurisdictions, the COFOG classifications adopted in respect of the GGS disclosures may be similar to the classifications adopted in accordance with IPSAS 18.

39. Entities will also make any additional disclosures that are necessary for users to understand the nature of the information presented.

40. **Entities preparing GGS disclosures shall disclose the significant controlled entities that are included in the GGS, and any changes in those entities from the prior period, together with an explanation of the reasons why any such entity that was previously included in the GGS is no longer included.**

41. This Standard requires entities electing to disclose information about the GGS to disclose a list of the significant controlled entities that are included in the GGS. IPSAS 35 requires entities preparing consolidated financial statements to disclose a list of the significant controlled entities that are included in the consolidated financial statements. Disclosure of which of the entities consolidated in the financial statements in accordance with IPSAS 35 are included in the GGS will assist users in developing an understanding of the relationship between information about the government and its GGS, and in better understanding the GGS information itself.

42. Similarly, disclosure of changes in the controlled entities included in the GGS will enable users to monitor the relationship between the consolidated financial statements and the GGS information over time.

Reconciliation to the Consolidated Financial Statements

43. **The GGS disclosures shall be reconciled to the consolidated financial statements of the government, showing separately the amount of the adjustment to each equivalent item in those financial statements.**

44. This Standard requires the amounts disclosed in respect of the GGS to be reconciled to their equivalent amounts in the consolidated financial statements of the government. Entities will present separately the adjustment in the amount of the asset investment in PFC and PNFC sectors determined in accordance with paragraph 23, and adjustments to each of the items disclosed separately in accordance with paragraph 35. In addition, entities may, but are not required to, disclose separately the amount of the adjustment to each item attributable to the PFC and the PNFC sectors. This reconciliation will enable the government to better discharge its accountability obligations by demonstrating the relationship between the amounts of each item for the GGS with the total amount of that item for the government.

Reconciliation to Statistical Bases of Financial Reporting

45. Statistical bases of financial reporting and IPSASs have many similarities in their treatment of particular transactions and events. However, there are also differences. For example, in addition to differences in the measurement bases for assets and liabilities outlined in paragraph 32 above, statistical bases of financial reporting treat dividends as expenses, while IPSASs treat them as distributions. Statistical bases of financial reporting also make a distinction between transactions and other economic flows for presentation of financial information that is not currently reflected in the consolidated financial statements, and focus on particular measures relevant for analysis of fiscal policy such as net lending/borrowing and cash surplus/deficit.

46. This Standard does not require a reconciliation of the GGS disclosures in the consolidated financial statements with the GGS disclosures under statistical bases of financial reporting. This is because of concerns about the practicability, and the costs and benefits, of such a requirement in all jurisdictions. However, the inclusion of such a reconciliation by way of note disclosure is not precluded.

Effective Date

47. **An entity shall apply this 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.**

47A. **Paragraph 48 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial**

statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.

47B. **IPSAS 35, *Consolidated Financial Statements* issued in January 2015, amended paragraphs 24, 26, 27, 29, 30, and 41. An entity shall apply those amendments when it applies IPSAS 35.**

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

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 22.

Introduction

BC1. The *System of National Accounts 1993* (SNA 1993) (and updates), *Government Finance Statistics Manual 2001* (GFSM) 2001, and the *European System of Accounts 1995* (ESA 1995), all require governments to publish financial information about the GGS. For statistical purposes, the GGS comprises government-controlled entities primarily engaged in nonmarket activities. The GGS is sometimes described as comprising those entities that fulfill the core functions of government as their primary activity. The GGS does not include public corporations, even when all the equity of such corporations is owned by the government or government entities.

BC2. Current IPSASs do not require entities to disclose information about the GGS in their financial statements. IPSASs require entities to prepare financial statements that include information about all the resources controlled by the reporting entity, and prescribe rules for consolidation of all controlled entities. IPSAS 18, *Segment Reporting*, also requires entities to identify segments and present information about those segments.

BC3. Some governments prepare, present, and widely publish both financial statements and information about the financial characteristics and performance of the public sector prepared in accordance with statistical bases of reporting.

BC4. The IPSASB supports the convergence of IPSASs with statistical bases of reporting where appropriate. The statistical community encouraged the IPSASB to develop an IPSAS addressing the presentation of GGS information as part of a government's consolidated financial statements as a means of facilitating convergence.

BC5. The disclosure of GGS information can provide useful information to users of financial statements, particularly in those jurisdictions in which national or other governments publish both (a) financial statements in accordance with IPSASs, and (b) financial information in accordance with statistical bases of financial reporting. The IPSASB is also of the view that the disclosure of such information can assist users in better understanding the relationship between the market and nonmarket activities of the government. However, the IPSASB is not persuaded that the benefits of making such disclosures may be significantly greater than their costs in those jurisdictions where financial statements prepared in accordance with statistical bases of financial reporting are not routinely prepared and made publicly available. Consequently, these disclosures are not mandatory.

BC6. This Standard specifies requirements for application only by governments. This is because it is only possible to disclose a meaningful representation of the GGS for a government as a whole. In some jurisdictions, national governments may control provincial and/or local governments. Where this occurs, the financial statements may be further disaggregated to separately disclose information about the GGS for each level of government. Such disclosure is likely to assist users to better understand the relationship between the GGS activities of each level of government. However, in some jurisdictions, such disclosures may impose additional pressure on the accounting system and those responsible for data collection and aggregation, and it is not clear that the benefits of such disclosure for users of the financial statements will exceed their cost. Therefore, this Standard does not require entities that elect to disclose information about the GGS to also disclose separately information about the GGS of each level of government consolidated in the financial statements. However, such disclosures are not precluded.

Consolidation and Disaggregation

BC7. Statistical bases of financial reporting and IPSASs have many similarities in their treatment of particular transactions and events. However, there are also differences. For example, statistical bases of financial reporting:

(a) Require all assets and liabilities (except loans) to be revalued to market value at each reporting date. IPSASs include different measurement requirements, and require or permit cost and current values for certain classes of assets and liabilities;

(b) Treat dividends as expenses, while IPSASs treat them as distributions;

(c) Make a distinction between transactions and other economic flows for presentation of financial information. IPSASs do not currently make a similar distinction; and

(d) Focus on the presentation of financial information about the GGS and the other sectors of the public sector as separate components and, in this context, adopt the same rules for recognition and measurement as are adopted for presentation of the rest of the economy, to ensure consistency of the macro-economic totals. Under statistical bases of financial reporting, financial statements prepared for the GGS do not include consolidation of PNFCs, being government-controlled entities that trade in goods and services, and PFCs such as banks. The IPSASs focus on consolidated financial statements which present financial information about all the assets, liabilities, revenues, expenses, and cash flows controlled by the entity.

BC8. This Standard requires that the disclosure of information about the GGS be a disaggregation of a government's consolidated financial statements. This is a similar perspective that is adopted for disclosure of segment information in accordance with IPSAS 18. Accordingly, the same accounting policies as those adopted for the consolidated financial statements are to be adopted in making GGS disclosures, with one exception as noted below.

BC9. When GGS disclosures are made in financial statements, the requirements of IPSAS 35 should not be applied in respect of PFCs and PNFCs. This is because the application of IPSAS 35 to the PFC and PNFC sectors would result in the re-presentation of a government's consolidated financial statements rather than the GGS financial statements. This would defeat the purpose of the disclosure of GGS information as a bridge between financial statements prepared in accordance with IPSASs and those prepared in accordance with statistical bases of financial reporting.

Segment Reporting

BC10. IPSAS 18 requires the separate disclosure of certain information about significant activities or groups of activities for the evaluation of the performance of the entity in achieving its objectives, and for decision-making purposes. IPSAS 18 does not distinguish between exchange and non-exchange transactions and events, or market and nonmarket activity of government. Rather, its focus is on the disclosure of the revenues, expenses, assets, and liabilities associated with the delivery of major services or groups of services – whether these services are delivered by the GGS of the government or by PFCs and PNFCs. The objective of segment reporting is not achieved by the disclosure of information about the GGS. Accordingly, a government electing to disclose information about the GGS needs also to disclose information about segments.

BC11. Statistical bases of financial reporting present information about expenses or expenditure of the government, classified either by economic nature or the COFOG. Either of these classification bases may be applied to disclose additional information about the GGS. In some cases a COFOG classification may be adopted to disclose segment information in a government's consolidated financial statements.

Reconciliation

BC12. The information disclosed about the GGS in accordance with the requirements of this Standard may differ in content and form from that presented under statistical bases of financial reporting.

BC13. The IPSASB considered whether those governments that elect to disclose information about the GGS in accordance with this Standard should be required to disclose a reconciliation of (a) the GGS disclosures in the financial statements, and (b) the GGS disclosures under statistical bases of financial reporting. The IPSASB was concerned that such a requirement may impose significant costs on the preparer, and that those costs may be greater than the benefits in some jurisdictions. This would then discourage governments that might otherwise elect to make such disclosures. Of particular concern to the IPSASB in this respect was, for example, whether the:

(a) Timing of compilation of financial statements and statistical information is such that a reconciliation could be completed within the timeframe necessary for the financial statements to be audited and signed off or authorized for issue in accordance with legislative requirements and/or requirements of the IPSASs;

(b) Inclusion of such a requirement would trigger an audit of the reconciliation, and may also trigger an audit of the statistical reports themselves; and

(c) Entity may be required to remeasure and reclassify assets, liabilities, revenues, and expenses in accordance with the requirements of the statistical bases of financial reporting, and whether this would discourage disclosure of the GGS information.

BC14. On balance, the IPSASB concluded that such a reconciliation should not be required at this stage. However, a reconciliation of the GGS disclosures, presented in accordance with the requirements of this Standard to the equivalent items in the financial statements of the government prepared in accordance with the requirements of IPSASs, (a) is consistent with enhanced transparency, (b) is not onerous, and (c) would be useful to users. The disclosure of a reconciliation of the GGS disclosures presented in accordance with the requirements of this Standard and the GGS disclosures presented under statistical bases of financial reporting is not prohibited.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 22.

Illustrative Financial Statement Structure

Government A—Extract Of Financial Statements

Extract from the Notes to the Financial Statements

Note: General Government Sector (GGS) Disclosures

The following disclosures are made for the general government sector (GGS). They reflect the accounting policies adopted in the consolidated financial statements, except that the consolidation requirements have been varied in respect of the public financial corporations (PFCs) sector and public nonfinancial corporations (PNFCs) sector. In accordance with the requirements of IPSAS 22, *Disclosure of Financial Information about the General Government Sector*, PFCs and PNFCs are not consolidated in the GGS disclosures, but are recognized as investments of the GGS. The investments in PFCs and PNFCs are presented as a single line item, measured at the carrying amount of the net assets of the investees.

The GGS comprises all central government ministries and other entities controlled by the government that are primarily engaged in nonmarket activities. These entities are:

Ministry of x

y

z.

During the reporting period, activities related to the postal service, previously undertaken by the ministry of communications, have been reconstituted on a commercial basis and are no longer included in the financial information presented for the GGS.

Statement of Financial Position for the GGS—As At December 31, 20X2

(in thousands of currency units)

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1
ASSETS								
Current assets								
Cash and cash equivalents	X	X	X	X	(X)	(X)	X	X
Receivables	X	X	X	X	(X)	(X)	X	X
Inventories	X	X	X	X			X	X
Prepayments	X	X	X	X	(X)	(X)	X	X
Investment	X	X	X	X			X	X
Other current assets	X	X	X	X			X	X
	X	X	X	X	(X)	(X)	X	X
Non-current assets								
Receivables	X	X	X	X	(X)	(X)	X	X
Investments	X	X	X	X			X	X
Investment in other sectors	X	X			(X)	(X)		
Other financial assets	X	X	X	X	(X)	(X)	X	X
Infrastructure, plant, and equipment	X	X	X	X			X	X
Land and buildings	X	X	X	X			X	X
Intangible assets	X	X	X	X			X	X
Other non-financial assets	X	X	X	X			X	X
	X	X	X	X	(X)	(X)	X	X
TOTAL ASSETS	X	X	X	X	(X)	(X)	X	X
LIABILITIES								
Current liabilities								
Payables	X	X	X	X	(X)	(X)	X	X
Short-term borrowings	X	X	X	X			X	X
Current portion of borrowings	X	X	X	X			X	X
Provisions	X	X	X	X			X	X
Employee benefits	X	X	X	X			X	X
Other current liabilities	X	X	X	X	(X)	(X)	X	X

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
	X	X	X	X	(X)	(X)	X	X
Non-current liabilities								
Payables	X	X	X	X	(X)	(X)	X	X
Borrowings	X	X	X	X			X	X
Provisions	X	X	X	X			X	X
Employee benefits	X	X	X	X			X	X
Other liabilities	X	X	X	X	(X)	(X)	X	X
	X	X	X	X	(X)	(X)	X	X
TOTAL LIABILITIES	X	X	X	X	(X)	(X)	X	X
NET ASSETS	X	X	X	X	(X)	(X)	X	X
NET ASSETS/EQUITY								
Reserves	X	X	X	X	(X)	(X)	X	X
Accumulated surpluses/ (deficits)	X	X	X	X	(X)	(X)	X	X
	X	X	X	X	(X)	(X)	X	X
TOTAL NET ASSETS/ EQUITY	X	X	X	X	(X)	(X)	X	X

**Statement of Financial Performance for the GGS—
For Year Ended December 31, 20X2—Classification of Function of Government**

(in thousands of currency units)

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
Revenue								
Taxes	X	X			(X)	(X)	X	X
Fees, fines, penalties	X	X	X	X	(X)	(X)	X	X
Revenue from other sectors	X	X	X	X	(X)	(X)		
Transfers from other governments	X	X	X	X			X	X
Other operating revenue	X	X	X	X	(X)	(X)	X	X
Total revenue	X	X	X	X	(X)	(X)	X	X
Expenses								
General public services	X	X					X	X
Defense	X	X					X	X
Public order and safety	X	X	X	X			X	X
Economic affairs	X	X					X	X
Environmental protection	X	X	X	X	(X)	(X)	X	X
Housing and community amenities	X	X	X	X	(X)	(X)	X	X
Health	X	X	X	X			X	X
Recreational, cultural, and religious	X	X					X	X
Education	X	X	X	X	(X)	(X)	X	X
Social protection	X	X	X	X	(X)	(X)	X	X
Total expenses	X	X	X	X	(X)	(X)	X	X
Surplus/(deficit) for the period	X	X	X	X	(X)	(X)	X	X

**Statement of Financial Performance for the GGS—
For Year Ended December 31, 20X2—Economic Classification of Expense
(Alternative Presentation Method)**

(in thousands of currency units)

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
Revenue								
Taxes	X	X			(X)	(X)	X	X
Fees, fines, penalties	X	X	X	X	(X)	(X)	X	X
Revenue from other sectors	X	X	X	X	(X)	(X)		
Transfers from other governments	X	X	X	X			X	X
Other operating revenue	X	X	X	X	(X)	(X)	X	X
Total revenue	X	X	X	X	(X)	(X)	X	X
Expenses								
Compensation of Employees	X	X	X	X	(X)	(X)	X	X
Use of Goods and Services	X	X	X	X	(X)	(X)	X	X
Consumption of Fixed Capital	X	X	X	X	(X)	(X)	X	X
Interest	X	X	X	X	(X)	(X)	X	X
Subsidies	X	X	X	X	(X)	(X)	X	X
Social Benefits	X	X	X	X	(X)	(X)	X	X
Other Expense	X	X	X	X			X	X
Total expenses	X	X	X	X	(X)	(X)	X	X
Surplus/(deficit)	X	X	X	X	(X)	(X)	X	X

Statement of Changes in Net Assets/Equity for the GGS—
For The Year Ended December 31, 20X2

(in thousands of currency units)

	GGS					
	Reval-uation Reserve	**Trans-lation Reserve**	**Accumu-lated Surpluses /(Deficits)**	**PFC and PNFC**	**Elim-inations**	**Total W-of-G**
Balance at December 31, 20X0	X	(X)	X	X	X	X
Surplus on revaluation of property	X			X		X
Deficit on revaluation of investments	(X)			(X)	X	(X)
Currency translation differences		(X)		(X)		(X)
Net gains and losses not recognized in the statement of financial performance	X	(X)		X	(X)	X
Net surplus for the period			X	X	(X)	X
Balance at December 31, 20X1	X	(X)	X	X	(X)	X
Deficit on revaluation of property	(X)			(X)	X	(X)
Surplus on revaluation of investments	X			X	(X)	X
Currency translation differences		(X)		X		X
Net gains and losses not recognized in the statement of financial performance	(X)	(X)		(X)	(X)	(X)
Net deficit for the period			(X)	(X)	(X)	(X)
Balance at December 31, 20X2	X	(X)	X	X	(X)	X

Cash Flow Statement for the GGS -
For Year Ended December 31, 20X2

(in thousands of currency units)

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
CASH FLOWS FROM OPERATING ACTIVITIES								
Receipts								
Taxation	X	X			(X)	(X)	X	X
Sales of goods and services			X	X	(X)	(X)	X	X
Grants			X	X	(X)	(X)	X	X
Interest received			X	X			X	X
Dividends from other sectors to government	X	X			(X)	(X)		
Other receipts	X	X	X	X	(X)	(X)	X	X
Payments								
Employee costs	(X)	(X)	(X)	(X)			(X)	(X)
Retirement Benefits	(X)	(X)	(X)	(X)			(X)	(X)
Suppliers	(X)	(X)	(X)	(X)			(X)	(X)
Interest paid	(X)	(X)	(X)	(X)			(X)	(X)
Dividend to other sectors			(X)	(X)	X	X		
Other payments	(X)	(X)	(X)	(X)	X	X	(X)	(X)
Net cash flows from operating activities	X	X	X	X	(X)	(X)	X	X
CASH FLOWS FROM INVESTING ACTIVITIES								
Purchase of plant and equipment	(X)	(X)	(X)	(X)			(X)	(X)
Proceeds from sale of plant and equipment	X	X	X	X			X	X
Proceeds from sale of investments	X	X	X	X			X	X
Purchase of foreign currency securities	(X)	(X)	(X)	(X)			(X)	(X)

	GGS		**PFC and PNFC**		**Eliminations**		**Total W-of-G**	
	20X2	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
Net cash flows from investing activities	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
CASH FLOWS FROM FINANCING ACTIVITIES								
Proceeds from borrowings	X	X	X	X			X	X
Repayment of borrowings	(X)	(X)	(X)	(X)			(X)	(X)
Net cash flows from financing activities	X	X	X	X	(X)	(X)	X	X
Net increase/(decrease) in cash and cash equivalents	X	X	X	X	(X)	(X)	X	X
Cash and cash equivalents at beginning of period	X	X	X	X	(X)	(X)	X	X
Cash and cash equivalents at end of period	X	X	X	X	(X)	(X)	X	X

IPSAS 23—REVENUE FROM NON-EXCHANGE TRANSACTIONS (TAXES AND TRANSFERS)

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* was issued in December 2006.

Since then, IPSAS 23 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- Improvements to IPSASs 2011 (issued October 2011)
- IPSAS 28, *Financial Instruments: Presentation* (issued January 2010)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)
- IPSAS 31, *Intangible Assets* (issued January 2010)

Table of Amended Paragraphs in IPSAS 23

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
5	Amended	IPSAS 29 January 2010
10	Amended	IPSAS 29 January 2010
37	Amended	IPSAS 28 January 2010
87	Amended	IPSAS 29 January 2010
105A	New	IPSAS 29 January 2010
105B	New	IPSAS 29 January 2010
106	Amended	IPSAS 29 January 2010
116	Deleted	IPSAS 33 January 2015
117	Deleted	IPSAS 33 January 2015
118	Deleted	IPSAS 33 January 2015
119	Deleted	IPSAS 33 January 2015

Paragraph Affected	How Affected	Affected By
120	Deleted	IPSAS 33 January 2015
121	Deleted	IPSAS 33 January 2015
122	Deleted	IPSAS 33 January 2015
123	Deleted	IPSAS 33 January 2015
124A	New	IPSAS 28 January 2010
124B	New	IPSAS 29 January 2010
124C	New	IPSAS 33 January 2015
125	Amended	IPSAS 33 January 2015
IG27	Amended	IPSAS 31 January 2010
IG54	New	IPSAS 29 January 2010

December 2006

IPSAS 23—REVENUE FROM NON-EXCHANGE TRANSACTIONS (TAXES AND TRANSFERS)

CONTENTS

International Public Sector Accounting Standard 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, is set out in paragraphs 1–125. All the paragraphs have equal authority. IPSAS 23 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe requirements for the financial reporting of revenue arising from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination. This Standard deals with issues that need to be considered in recognizing and measuring revenue from non-exchange transactions, including the identification of contributions from owners.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for revenue from non-exchange transactions. This Standard does not apply to an entity combination that is a non-exchange transaction.**

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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

5. This Standard addresses revenue arising from non-exchange transactions. Revenue arising from exchange transactions is addressed in IPSAS 9, *Revenue from Exchange Transactions*. While revenues received by public sector entities arise from both exchange and non-exchange transactions, the majority of revenue of governments and other public sector entities is typically derived from non-exchange transactions, such as:

    (a) Taxes; and

    (b) Transfers (whether cash or noncash), including grants, debt forgiveness, fines, bequests, gifts, donations, goods and services in-kind, and the off-market portion of concessionary loans received.

6. Governments may reorganize the public sector, merging some public sector entities, and dividing other entities into two or more separate entities. An entity combination occurs when two or more reporting entities are brought together to form one reporting entity. These restructurings do not ordinarily involve one entity purchasing another entity, but may result in a new or existing entity acquiring all the assets and liabilities of another entity. The IPSASB has not addressed entity combinations, and has excluded them from the scope of this Standard. Therefore, this Standard does not specify whether an entity combination, which is a non-exchange transaction, will give rise to revenue or not.

Definitions

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

Conditions on transferred assets are stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.

Control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives, and can exclude or otherwise regulate the access of others to that benefit.

Expenses paid through the tax system are amounts that are available to beneficiaries regardless of whether or not they pay taxes.

Fines are economic benefits or service potential received or receivable by public sector entities, as determined by a court or other law enforcement body, as a consequence of the breach of laws or regulations.

Restrictions on transferred assets are stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified.

Stipulations on transferred assets are terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.

Tax expenditures are preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.

The taxable event is the event that the government, legislature, or other authority has determined will be subject to taxation.

Taxes are economic benefits or service potential compulsorily paid or payable to public sector entities, in accordance with laws and/or regulations, established to provide revenue to the government. Taxes do not include fines or other penalties imposed for breaches of the law.

Transfers are inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.

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

Non-Exchange Transactions

8. In some transactions, it is clear that there is an exchange of approximately equal value. These are exchange transactions and are addressed in other IPSASs.

9. In other transactions, an entity will receive resources and provide no or nominal consideration directly in return. These are clearly non-exchange transactions and are addressed in this Standard. For example, taxpayers pay taxes because the tax law mandates the payment of those taxes. While the taxing government will provide a variety of public services to taxpayers, it does not do so in consideration for the payment of taxes.

10. There is a further group of non-exchange transactions where the entity may provide some consideration directly in return for the resources received, but that consideration does not approximate the fair value of the resources received. In these cases, the entity determines whether there is a combination of exchange and non-exchange transactions, each component of which is recognized separately. For example, an entity receives CU6 million funding from a multi-lateral development agency. The agreement stipulates that the entity must repay CU5 million of the funding received over a period of 10 years, at 5% interest when the market rate for a similar loan is 11%. The entity has effectively received a CU1 million grant (CU6 million received less CU5 million to be repaid) and entered into CU5 million concessionary loan which attracts interest at 6% below the market interest rate for a similar loan. The CU1 million grant received, as well as the off-market portion of the interest payments in terms of the agreement, are non-exchange transactions. The contractual capital and interest payments over the period of the loan are exchange transactions.

11. There are also additional transactions where it is not immediately clear whether they are exchange or non-exchange transactions. In these cases an examination of the substance of the transaction will determine if they are exchange or non-exchange transactions. For example, the sale of goods is normally classified as an exchange transaction. If, however, the transaction is conducted at a subsidized price, that is, a price that is not approximately equal to the fair value of the goods sold, that transaction falls within the definition of a non-exchange transaction. In determining whether the substance of a transaction is that of a non-exchange or an exchange transaction, professional judgment is exercised. In addition, entities may receive trade discounts, quantity discounts, or other reductions in the quoted price of assets for a variety of reasons. These reductions in price do not necessarily mean that the transaction is a non-exchange transaction.

Revenue

12. Revenue comprises gross inflows of economic benefits or service potential received and receivable by the reporting entity, which represents an increase in net assets/equity, other than increases relating to contributions from owners. Amounts collected as an agent of the government or another government organization or other third parties will not give rise to an increase in net assets or revenue of the agent. This is because the agent entity cannot control the use of, or otherwise benefit from, the collected assets in the pursuit of its objectives.

13. Where an entity incurs some cost in relation to revenue arising from a non-exchange transaction, the revenue is the gross inflow of future economic benefits or service potential, and any outflow of resources is recognized as a cost of the transaction. For example, if a reporting entity is required to pay delivery and installation costs in relation to the transfer of an item of plant to it from another entity, those costs are recognized separately from revenue arising from the transfer of the item of plant. Delivery and installation costs are included in the amount recognized as an asset, in accordance with IPSAS 17, *Property, Plant, and Equipment.*

Stipulations

14. Assets may be transferred with the expectation and/or understanding that they will be used in a particular way and, therefore, that the recipient entity will act or perform in a particular way. Where laws, regulations, or binding arrangements with external parties impose terms on the use of transferred assets by the recipient, these terms are stipulations, as defined in this Standard. A key feature of stipulations, as defined in this Standard, is that an entity cannot impose a stipulation on itself, whether directly or through an entity that it controls.

15. Stipulations relating to a transferred asset may be either conditions or restrictions. While conditions and restrictions may require an entity to use or consume the future economic benefits or service potential embodied in an asset for a particular purpose (performance obligation) on initial recognition, only conditions require that future economic benefits or service potential be returned to the transferor in the event that the stipulation is breached (return obligation).

16. Stipulations are enforceable through legal or administrative processes. If a term in laws or regulations or other binding arrangements is unenforceable, it is not a stipulation as defined by this Standard. Constructive obligations do not arise from stipulations. IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, establishes requirements for the recognition and measurement of constructive obligations.

Conditions on Transferred Assets

17. Conditions on transferred assets (hereafter referred to as conditions) require that the entity either consume the future economic benefits or service potential of the asset as specified, or return future economic benefits or service potential to the transferor in the event that the conditions are breached. Therefore, the recipient incurs a present obligation to transfer future economic benefits or service potential to third parties when it initially gains control of an asset subject to a condition. This is because the recipient is unable to avoid the outflow of resources, as it is required to consume the future economic benefits or service potential embodied in the transferred asset in the delivery of particular goods or services to third parties, or else to return to the transferor future economic benefits or service potential. Therefore, when a recipient initially recognizes an asset that is subject to a condition, the recipient also incurs a liability.

18. As an administrative convenience, a transferred asset, or other future economic benefits or service potential, may be effectively returned by deducting the amount to be returned from other assets due to be transferred for other purposes. The reporting entity will still recognize the gross amounts in its financial statements, that is, the entity will recognize a reduction in assets and liabilities for the return of the asset under the terms of the breached condition, and will reflect the recognition of assets, liabilities, and/or revenue for the new transfer.

Restrictions on Transferred Assets

19. Restrictions on transferred assets (hereafter referred to as restrictions) do not include a requirement that the transferred asset, or other future economic benefits or service potential, is to be returned to the transferor if the asset is not deployed as specified. Therefore, gaining control of an asset subject to a restriction does not impose on the recipient a present obligation to transfer future economic benefits or service potential to third parties when control of the asset is initially gained. Where a recipient is in breach of a restriction, the transferor, or another party, may have the option of seeking a penalty against the recipient, by, for example, taking the matter to a court or other tribunal, or through an administrative process such as a directive from a government minister or other authority, or otherwise. Such actions may result in the entity being directed to fulfill the restriction or face a civil or criminal penalty for defying the court, other tribunal, or authority. Such a penalty is not incurred as a result of acquiring the asset, but as a result of breaching the restriction.

Substance over Form

20. In determining whether a stipulation is a condition or a restriction, it is necessary to consider the substance of the terms of the stipulation and not merely its form. The mere specification that, for example, a transferred asset

is required to be consumed in providing goods and services to third parties or be returned to the transferor is, in itself, not sufficient to give rise to a liability when the entity gains control of the asset.

21. In determining whether a stipulation is a condition or restriction, the entity considers whether a requirement to return the asset or other future economic benefits or service potential is enforceable, and would be enforced by the transferor. If the transferor could not enforce a requirement to return the asset or other future economic benefits or service potential, the stipulation fails to meet the definition of a condition, and will be considered a restriction. If past experience with the transferor indicates that the transferor never enforces the requirement to return the transferred asset or other future economic benefits or service potential when breaches have occurred, then the recipient entity may conclude that the stipulation has the form but not the substance of a condition, and is, therefore, a restriction. If the entity has no experience with the transferor, or has not previously breached stipulations that would prompt the transferor to decide whether to enforce a return of the asset or other future economic benefits or service potential, and it has no evidence to the contrary, it would assume that the transferor would enforce the stipulation and, therefore, the stipulation meets the definition of a condition.

22. The definition of a condition imposes on the recipient entity a performance obligation – that is, the recipient is required to consume the future economic benefits or service potential embedded in the transferred asset as specified, or return the asset or other future economic benefits or service potential to the transferor. To satisfy the definition of a condition, the performance obligation will be one of substance not merely form, and is required as a consequence of the condition itself. A term in a transfer agreement that requires the entity to perform an action that it has no alternative but to perform may lead the entity to conclude that the term is in substance neither a condition nor a restriction. This is because, in these cases, the terms of the transfer itself do not impose on the recipient entity a performance obligation.

23. To satisfy the criteria for recognition as a liability, it is necessary that an outflow of resources will be probable, and performance against the condition is required and is able to be assessed. Therefore, a condition will need to specify such matters as the nature or quantity of the goods and services to be provided or the nature of assets to be acquired as appropriate and, if relevant, the periods within which performance is to occur. In addition, performance will need to be monitored by, or on behalf of, the transferor on an ongoing basis. This is particularly so where a stipulation provides for a proportionate return of the equivalent value of the asset if the entity partially performs the requirements of the condition, and the return obligation has been enforced if significant failures to perform have occurred in the past.

24. In some cases, an asset may be transferred subject to the stipulation that it be returned to the transferor if a specified future event does not occur. This may

occur where, for example, a national government provides funds to a provincial government entity subject to the stipulation that the entity raise a matching contribution. In these cases, a return obligation does not arise until such time as it is expected that the stipulation will be breached, and a liability is not recognized until the recognition criteria have been satisfied.

25. However, recipients will need to consider whether these transfers are in the nature of an advance receipt. In this Standard, advance receipt refers to resources received prior to a taxable event or a transfer arrangement becoming binding. Advance receipts give rise to an asset and a present obligation because the transfer arrangement has not yet become binding. Where such transfers are in the nature of an exchange transaction, they will be dealt with in accordance with IPSAS 9.

Taxes

26. Taxes are the major source of revenue for many governments and other public sector entities. Taxes are defined in paragraph 7 as economic benefits compulsorily paid or payable to public sector entities, in accordance with laws or regulation, established to provide revenue to the government, excluding fines or other penalties imposed for breaches of laws or regulation. Noncompulsory transfers to the government or public sector entities such as donations and the payment of fees are not taxes, although they may be the result of non-exchange transactions. A government levies taxation on individuals and other entities, known as taxpayers, within its jurisdiction by use of its sovereign powers.

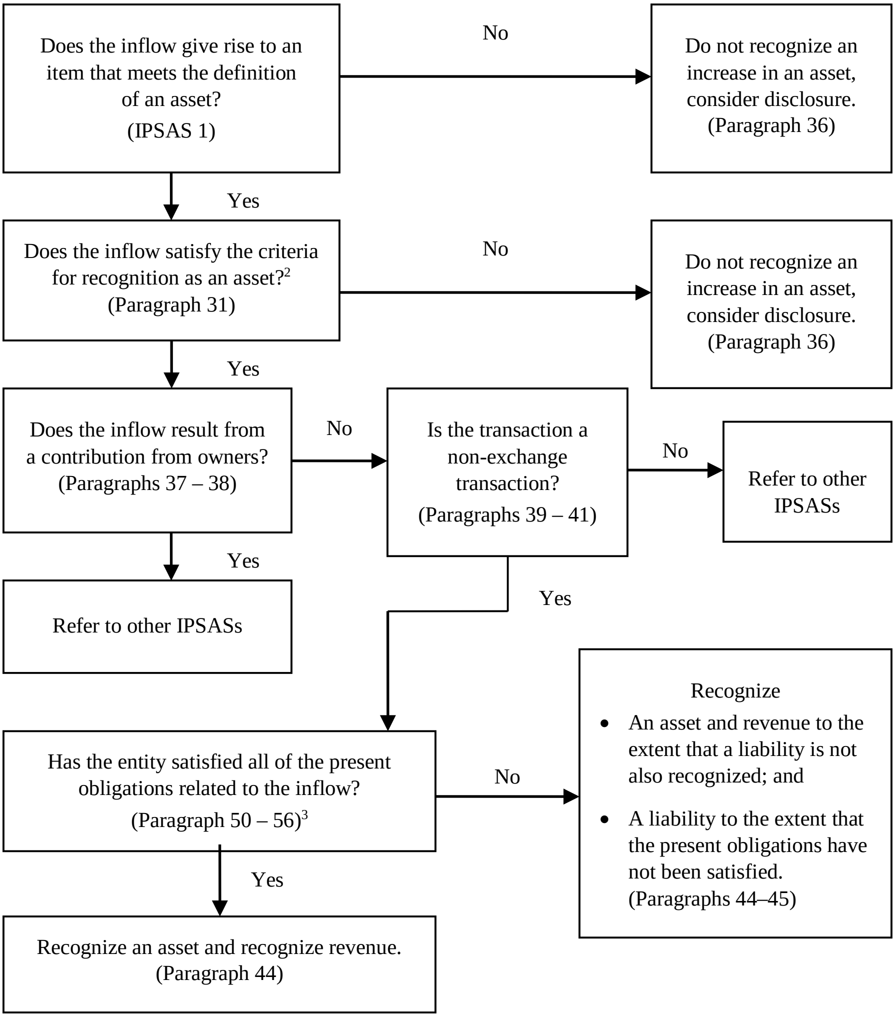
27. Tax laws and regulations can vary significantly from jurisdiction to jurisdiction, but they have a number of common characteristics. Tax laws and regulations (a) establish a government's right to collect the tax, (b) identify the basis on which the tax is calculated, and (c) establish procedures to administer the tax, that is, procedures to calculate the tax receivable and ensure payment is received. Tax laws and regulations often require taxpayers to file periodic returns to the government agency that administers a particular tax. The taxpayer generally provides details and evidence of the level of activity subject to tax, and the amount of tax receivable by the government is calculated. Arrangements for receipt of taxes vary widely but are normally designed to ensure that the government receives payments on a regular basis without resorting to legal action. Tax laws are usually rigorously enforced and often impose severe penalties on individuals or other entities breaching the law.

28. Advance receipts, being amounts received in advance of the taxable event, may also arise in respect of taxes.

Analysis of the Initial Inflow of Resources from Non-Exchange Transactions

29. An entity will recognize an asset arising from a non-exchange transaction when it gains control of resources that meet the definition of an asset and satisfy the recognition criteria. In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset, the entity decreases the carrying amount of the liability. In some cases, gaining control of the asset may also carry with it obligations that the entity will recognize as a liability. Contributions from owners do not give rise to revenue, so each type of transaction is analyzed, and any contributions from owners are accounted for separately. Consistent with the approach set out in this Standard, entities will analyze non-exchange transactions to determine which elements of general purpose financial statements will be recognized as a result of the transactions. The flow chart on the following page illustrates the analytic process an entity undertakes when there is an inflow of resources to determine whether revenue arises. This Standard follows the structure of the flowchart. Requirements for the treatment of transactions are set out in paragraphs 30–115.

Illustration of the Analysis of Initial Inflows of Resources[1]



1. The flowchart is illustrative only, it does not take the place of this Standard. It is provided as an aid to interpreting this Standard.
2. In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset, the entity decreases the carrying amount of the liability.
3. In determining whether the entity has satisfied all of the present obligations, the application of the definition of conditions on a transferred asset, and the criteria for recognizing a liability, are considered.

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[1] The flowchart is illustrative only; it does not take the place of this Standard. It is provided as an aid to interpreting this Standard.

Recognition of Assets

30. Assets are defined in IPSAS 1 as 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.

31. **An inflow of resources from a non-exchange transaction, other than services in-kind, that meets the definition of an asset shall be recognized as an asset when, and only when:**

    (a) **It is probable that the future economic benefits or service potential associated with the asset will flow to the entity; and**

    (b) **The fair value of the asset can be measured reliably.**

Control of an Asset

32. The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. In the public sector, governments exercise a regulatory role over certain activities, for example, financial institutions or pension funds. This regulatory role does not necessarily mean that such regulated items meet the definition of an asset of the government, or satisfy the criteria for recognition as an asset in the general purpose financial statements of the government that regulates those assets. In accordance with paragraph 98, entities may, but are not required, to recognize services in-kind.

33. An announcement of an intention to transfer resources to a public sector entity is not of itself sufficient to identify resources as controlled by a recipient. For example, if a public school were destroyed by a forest fire and a government announced its intention to transfer funds to rebuild the school, the school would not recognize an inflow of resources (resources receivable) at the time of the announcement. In circumstances where a transfer agreement is required before resources can be transferred, a recipient entity will not identify resources as controlled until such time as the agreement is binding, because the recipient entity cannot exclude or regulate the access of the transferor to the resources. In many instances, the entity will need to establish enforceability of its control of resources before it can recognize an asset. If an entity does not have an enforceable claim to resources, it cannot exclude or regulate the transferor's access to those resources.

Past Event

34. Public sector entities normally obtain assets from governments, other entities including taxpayers, or by purchasing or producing them. Therefore, the past event that gives rise to control of an asset may be a purchase, a taxable event, or a transfer. Transactions or events expected to occur in the future do not in themselves give rise to assets – hence for example, an intention to levy

taxation is not a past event that gives rise to an asset in the form of a claim against a taxpayer.

Probable Inflow of Resources

35. An inflow of resources is probable when the inflow is more likely than not to occur. The entity bases this determination on its past experience with similar types of flows of resources and its expectations regarding the taxpayer or transferor. For example, where (a) a government agrees to transfer funds to a public sector entity (reporting entity), (b) the agreement is binding, and (c) the government has a history of transferring agreed resources, it is probable that the inflow will occur, notwithstanding that the funds have not been transferred at the reporting date.

Contingent Assets

36. An item that possesses the essential characteristics of an asset, but fails to satisfy the criteria for recognition, may warrant disclosure in the notes as a contingent asset (see IPSAS 19).

Contributions from Owners

37. Contributions from owners are defined in IPSAS 1. For a transaction to qualify as a contribution from owners, it will be necessary to satisfy the characteristics identified in that definition. In determining whether a transaction satisfies the definition of a contribution from owners, the substance rather than the form of the transaction is considered. Paragraph 38 indicates the form that contributions from owners may take. If, despite the form of the transaction, the substance is clearly that of a loan or another kind of liability, or revenue, the entity recognizes it as such and makes an appropriate disclosure in the notes to the general purpose financial statements, if material. For example, if a transaction purports to be a contribution from owners, but specifies that the reporting entity will pay fixed distributions to the transferor, with a return of the transferor's investment at a specified future time, the transaction is more characteristic of a loan. For contractual arrangements, an entity also considers the guidance in IPSAS 28, *Financial Instruments: Presentation* when distinguishing liabilities from contributions from owners.

38. A contribution from owners may be evidenced by, for example:

    (a) A formal designation of the transfer (or a class of such transfers) by the contributor or a controlling entity of the contributor as forming part of the recipient's contributed net assets/equity, either before the contribution occurs or at the time of the contribution;

(b) A formal agreement, in relation to the contribution, establishing or increasing an existing financial interest in the net assets/equity of the recipient that can be sold, transferred, or redeemed; or

(c) The issuance, in relation to the contribution, of equity instruments that can be sold, transferred, or redeemed.

Exchange and Non-Exchange Components of a Transaction

39. Paragraphs 40 and 41 below address circumstances in which an entity gains control of resources embodying future economic benefits or service potential other than by contributions from owners.

40. Paragraph 11 of IPSAS 9, defines exchange transactions and non-exchange transactions, and paragraph 10 of this Standard notes that a transaction may include two components, an exchange component and a non-exchange component.

41. Where an asset is acquired by means of a transaction that has an exchange component and a non-exchange component, the entity recognizes the exchange component according to the principles and requirements of other IPSASs. The non-exchange component is recognized according to the principles and requirements of this Standard. In determining whether a transaction has identifiable exchange and non-exchange components, professional judgment is exercised. Where it is not possible to distinguish separate exchange and non-exchange components, the transaction is treated as a non-exchange transaction.

Measurement of Assets on Initial Recognition

42. **An asset acquired through a non-exchange transaction shall initially be measured at its fair value as at the date of acquisition.**

43. Consistent with IPSAS 12, *Inventories,* IPSAS 16, *Investment Property,* and IPSAS 17, assets acquired through non-exchange transactions are measured at their fair value as at the date of acquisition.

Recognition of Revenue from Non-Exchange Transactions

44. **An inflow of resources from a non-exchange transaction recognized as an asset shall be recognized as revenue, except to the extent that a liability is also recognized in respect of the same inflow.**

45. **As an entity satisfies a present obligation recognized as a liability in respect of an inflow of resources from a non-exchange transaction recognized as an asset, it shall reduce the carrying amount of the liability recognized and recognize an amount of revenue equal to that reduction.**

46. When an entity recognizes an increase in net assets as a result of a non-exchange transaction, it recognizes revenue. If it has recognized a liability in

respect of the inflow of resources arising from the non-exchange transaction, when the liability is subsequently reduced, because the taxable event occurs or a condition is satisfied, it recognizes revenue. If an inflow of resources satisfies the definition of contributions from owners, it is not recognized as a liability or revenue.

47. The timing of revenue recognition is determined by the nature of the conditions and their settlement. For example, if a condition specifies that the entity is to provide goods or services to third parties, or return unused funds to the transferor, revenue is recognized as goods or services are provided.

Measurement of Revenue from Non-Exchange Transactions

48. **Revenue from non-exchange transactions shall be measured at the amount of the increase in net assets recognized by the entity.**

49. When, as a result of a non-exchange transaction, an entity recognizes an asset, it also recognizes revenue equivalent to the amount of the asset measured in accordance with paragraph 42, unless it is also required to recognize a liability. Where a liability is required to be recognized it will be measured in accordance with the requirements of paragraph 57, and the amount of the increase in net assets, if any, will be recognized as revenue. When a liability is subsequently reduced, because the taxable event occurs, or a condition is satisfied, the amount of the reduction in the liability will be recognized as revenue.

Present Obligations Recognized as Liabilities

50. **A present obligation arising from a non-exchange transaction that meets the definition of a liability shall be recognized as a liability when, and only when:**

    (a) **It is probable that an outflow of resources embodying future economic benefits or service potential will be required to settle the obligation; and**

    (b) **A reliable estimate can be made of the amount of the obligation.**

Present Obligation

51. A present obligation is a duty to act or perform in a certain way, and may give rise to a liability in respect of any non-exchange transaction. Present obligations may be imposed by stipulations in laws or regulations or binding arrangements establishing the basis of transfers. They may also arise from the normal operating environment, such as the recognition of advance receipts.

52. In many instances, taxes are levied and assets are transferred to public sector entities in non-exchange transactions pursuant to laws, regulation, or other

binding arrangements that impose stipulations that they be used for particular purposes. For example:

(a) Taxes, the use of which is limited by laws or regulations to specified purposes;

(b) Transfers, established by a binding arrangement that includes conditions:

(i) From national governments to provincial, state or local governments;

(ii) From state/provincial governments to local governments;

(iii) From governments to other public sector entities;

(iv) To governmental agencies that are created by laws or regulation to perform specific functions with operational autonomy, such as statutory authorities or regional boards or authorities; and

(v) From donor agencies to governments or other public sector entities.

53. In the normal course of operations, a reporting entity may accept resources prior to a taxable event occurring. In such circumstances, a liability of an amount equal to the amount of the advance receipt is recognized until the taxable event occurs.

54. If a reporting entity receives resources prior to the existence of a binding transfer arrangement, it recognizes a liability for an advance receipt until such time as the arrangement becomes binding.

Conditions on a Transferred Asset

55. **Conditions on a transferred asset give rise to a present obligation on initial recognition that will be recognized in accordance with paragraph 50.**

56. Stipulations are defined in paragraph 7. Paragraphs 14–25 provide guidance on determining whether a stipulation is a condition or a restriction. An entity analyzes any and all stipulations attached to an inflow of resources, to determine whether those stipulations impose conditions or restrictions.

Measurement of Liabilities on Initial Recognition

57. **The amount recognized as a liability shall be the best estimate of the amount required to settle the present obligation at the reporting date.**

58. The estimate takes account of the risks and uncertainties that surround the events causing the liability to be recognized. Where the time value of money is material, the liability will be measured at the present value of the amount

expected to be required to settle the obligation. This requirement is in accordance with the principles established in IPSAS 19.

Taxes

59. **An entity shall recognize an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met.**

60. Resources arising from taxes satisfy the definition of an asset when the entity controls the resources as a result of a past event (the taxable event) and expects to receive future economic benefits or service potential from those resources. Resources arising from taxes satisfy the criteria for recognition as an asset when it is probable that the inflow of resources will occur and their fair value can be reliably measured. The degree of probability attached to the inflow of resources is determined on the basis of evidence available at the time of initial recognition, which includes, but is not limited to, disclosure of the taxable event by the taxpayer.

61. Taxation revenue arises only for the government that imposes the tax, and not for other entities. For example, where the national government imposes a tax that is collected by its taxation agency, assets and revenue accrue to the government, not the taxation agency. Further, where a national government imposes a sales tax, the entire proceeds of which it passes to state governments, based on a continuing appropriation, the national government recognizes assets and revenue for the tax, and a decrease in assets and an expense for the transfer to state governments. The state governments will recognize assets and revenue for the transfer. Where a single entity collects taxes on behalf of several other entities, it is acting as an agent for all of them. For example, where a state taxation agency collects income tax for the state government and several city governments, it does not recognize revenue in respect of the taxes collected – rather, the individual governments that impose the taxes recognize assets and revenue in respect of the taxes.

62. Taxes do not satisfy the definition of contributions from owners, because the payment of taxes does not give the taxpayers a right to receive (a) distributions of future economic benefits or service potential by the entity during its life, or (b) distribution of any excess of assets over liabilities in the event of the government being wound up. Nor does the payment of taxes provide taxpayers with an ownership right in the government that can be sold, exchanged, transferred, or redeemed.

63. Taxes satisfy the definition of non-exchange transaction because the taxpayer transfers resources to the government, without receiving approximately equal value directly in exchange. While the taxpayer may benefit from a range of social policies established by the government, these are not provided directly in exchange as consideration for the payment of taxes.

64. As noted in paragraph 52, some taxes are levied for specific purposes. If the government is required to recognize a liability in respect of any conditions relating to assets recognized as a consequence of specific purpose tax levies, it does not recognize revenue until the condition is satisfied and the liability is reduced. However, in most cases, taxes levied for specific purposes are not expected to give rise to a liability, because the specific purposes amount to restrictions not conditions.

The Taxable Event

65. Similar types of taxes are levied in many jurisdictions. The reporting entity analyzes the taxation law in its own jurisdiction to determine what the taxable event is for the various taxes levied. Unless otherwise specified in laws or regulations, it is likely that the taxable event for:

(a) Income tax is the earning of assessable income during the taxation period by the taxpayer;

(b) Value-added tax is the undertaking of taxable activity during the taxation period by the taxpayer;

(c) Goods and services tax is the purchase or sale of taxable goods and services during the taxation period;

(d) Customs duty is the movement of dutiable goods or services across the customs boundary;

(e) Death duty is the death of a person owning taxable property; and

(f) Property tax is the passing of the date on which the tax is levied, or the period for which the tax is levied, if the tax is levied on a periodic basis.

Advance Receipts of Taxes

66. Consistent with the definitions of assets, liabilities, and the requirements of paragraph 59, resources for taxes received prior to the occurrence of the taxable event are recognized as an asset and a liability (advance receipts), because (a) the event that gives rise to the entity's entitlement to the taxes has not occurred, and (b) the criteria for recognition of taxation revenue have not been satisfied (see paragraph 59), notwithstanding that the entity has already received an inflow of resources. Advance receipts in respect of taxes are not fundamentally different from other advance receipts, so a liability is recognized until the taxable event occurs. When the taxable event occurs, the liability is discharged and revenue is recognized.

Measurement of Assets Arising from Taxation Transactions

67. Paragraph 42 requires that assets arising from taxation transactions be measured at their fair value as at the date of acquisition. Assets arising from

taxation transactions are measured at the best estimate of the inflow of resources to the entity. Reporting entities will develop accounting policies for the measurement of assets arising from taxation transactions that conform with the requirements of paragraph 42. The accounting policies for estimating these assets will take account of both the probability that the resources arising from taxation transactions will flow to the government, and the fair value of the resultant assets.

68. Where there is a separation between the timing of the taxable event and collection of taxes, public sector entities may reliably measure assets arising from taxation transactions by using, for example, statistical models based on the history of collecting the particular tax in prior periods. These models will include consideration of the timing of cash receipts from taxpayers, declarations made by taxpayers, and the relationship of taxation receivable to other events in the economy. Measurement models will also take account of other factors such as:

(a) The tax law allowing taxpayers a longer period to file returns than the government is permitted for publishing general purpose financial statements;

(b) Taxpayers failing to file returns on a timely basis;

(c) Valuing non-monetary assets for tax assessment purposes;

(d) Complexities in tax law requiring extended periods for assessing taxes due from certain taxpayers;

(e) The potential that the financial and political costs of rigorously enforcing the tax laws and collecting all the taxes legally due to the government may outweigh the benefits received;

(f) The tax law permitting taxpayers to defer payment of some taxes; and

(g) A variety of circumstances particular to individual taxes and jurisdictions.

69. Measuring assets and revenue arising from taxation transactions using statistical models may result in the actual amount of assets and revenue recognized being different from the amounts determined in subsequent reporting periods as being due from taxpayers in respect of the current reporting period. Revisions to estimates are made in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.

70. In some cases, the assets arising from taxation transactions and the related revenue cannot be reliably measured until sometime after the taxable event occurs. This may occur if a tax base is volatile and reliable estimation is not possible. In many cases, the assets and revenue may be recognized in the period subsequent to the occurrence of the taxable event. However, there are exceptional circumstances when several reporting periods will pass before a

taxable event results in an inflow of resources embodying future economic benefits or service potential that meets the definition of an asset and satisfies the criteria for recognition as an asset. For example, it may take several years to determine and reliably measure the amount of death duty due in respect of a large deceased estate because it includes a number of valuable antiques and artworks, which require specialist valuations. Consequently the recognition criteria may not be satisfied until payment is received or receivable.

Expenses Paid Through the Tax System and Tax Expenditures

71. **Taxation revenue shall be determined at a gross amount. It shall not be reduced for expenses paid through the tax system.**

72. In some jurisdictions, the government uses the tax system as a convenient method of paying to taxpayers benefits that would otherwise be paid using another payment method, such as writing a check, directly depositing the amount in a taxpayer's bank account, or settling another account on behalf of the taxpayer. For example, a government may pay part of residents' health insurance premiums, to encourage the uptake of such insurance, either by reducing the individual's tax liability, making a payment by check, or by paying an amount directly to the insurance company. In these cases, the amount is payable irrespective of whether the individual pays taxes. Consequently, this amount is an expense of the government and should be recognized separately in the statement of financial performance. Tax revenue should be increased for the amount of any of these expenses paid through the tax system.

73. **Taxation revenue shall not be grossed up for the amount of tax expenditures.**

74. In most jurisdictions, governments use the tax system to encourage certain financial behavior and discourage other behavior. For example, in some jurisdictions, homeowners are permitted to deduct mortgage interest and property taxes from their gross income when calculating tax-assessable income. These types of concessions are available only to taxpayers. If an entity (including a natural person) does not pay tax, it cannot access the concession. These types of concessions are called tax expenditures. Tax expenditures are foregone revenue, not expenses, and do not give rise to inflows or outflows of resources – that is, they do not give rise to assets, liabilities, revenue, or expenses of the taxing government.

75. The key distinction between expenses paid through the tax system and tax expenditures is that, for expenses paid through the tax system, the amount is available to recipients irrespective of whether they pay taxes, or use a particular mechanism to pay their taxes. IPSAS 1 prohibits the offsetting of items of revenue and expense unless permitted by another standard. The

offsetting of tax revenue and expenses paid through the tax system is not permitted.

Transfers

76. **Subject to paragraph 98, an entity shall recognize an asset in respect of transfers when the transferred resources meet the definition of an asset and satisfy the criteria for recognition as an asset.**

77. Transfers include grants, debt forgiveness, fines, bequests, gifts, donations, and goods and services in-kind. All these items have the common attribute that they transfer resources from one entity to another without providing approximately equal value in exchange, and are not taxes as defined in this Standard.

78. Transfers satisfy the definition of an asset when the entity controls the resources as a result of a past event (the transfer), and expects to receive future economic benefits or service potential from those resources. Transfers satisfy the criteria for recognition as an asset when it is probable that the inflow of resources will occur, and their fair value can be reliably measured. In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset as a result of the transfer, the entity decreases the carrying amount of the liability.

79. An entity obtains control of transferred resources either when the resources have been transferred to the entity, or the entity has an enforceable claim against the transferor. Many arrangements to transfer resources become binding on all parties before the transfer of resources takes place. However, sometimes one entity promises to transfer resources, but fails to do so. Consequently only when (a) a claim is enforceable, and (b) the entity assesses that it is probable that the inflow of resources will occur, will assets, liabilities, and/or revenue be recognized. Until that time, the entity cannot exclude or regulate the access of third parties to the benefits of the resources proposed for transfer.

80. Transfers of resources that satisfy the definition of contributions from owners will not give rise to revenue. Agreements (a) that specify that the entity providing resources is entitled to distributions of future economic benefits or service potential during the recipient entity's life, or distribution of any excess of assets over liabilities in the event that the recipient entity is wound up, or (b) that specify that the entity providing resources acquires a financial interest in the recipient entity that can be sold, exchanged, transferred, or redeemed, are, in substance, agreements to make a contribution from owners.

81. Transfers satisfy the definition of non-exchange transactions because the transferor provides resources to the recipient entity without the recipient entity providing approximately equal value directly in exchange. If an agreement

stipulates that the recipient entity is to provide approximately equal value in exchange, the agreement is not a transfer agreement, but a contract for an exchange transaction that should be accounted for under IPSAS 9.

82. An entity analyzes all stipulations contained in transfer agreements to determine if it incurs a liability when it accepts transferred resources.

Measurement of Transferred Assets

83. As required by paragraph 42, transferred assets are measured at their fair value as at the date of acquisition. Entities develop accounting policies for the recognition and measurement of assets that are consistent with IPSASs. As noted previously, inventories, property, plant, equipment, or investment property acquired through non-exchange transactions are to be initially measured at their fair value as at the date of acquisition, in accordance with the requirements of IPSAS 12, IPSAS 16, and IPSAS 17. Financial instruments, including cash and transfers receivable that satisfy the definition of a financial instrument, and other assets, will also be measured at fair value as at the date of acquisition in accordance with paragraph 42 and the appropriate accounting policy.

Debt Forgiveness and Assumption of Liabilities

84. Lenders will sometimes waive their right to collect a debt owed by a public sector entity, effectively canceling the debt. For example, a national government may cancel a loan owed by a local government. In such circumstances, the local government recognizes an increase in net assets because a liability it previously recognized is extinguished.

85. Entities recognize revenue in respect of debt forgiveness when the former debt no longer meets the definition of a liability or satisfies the criteria for recognition as a liability, provided that the debt forgiveness does not satisfy the definition of a contribution from owners.

86. Where a controlling entity forgives debt owed by a wholly owned controlled entity, or assumes its liabilities, the transaction may be a contribution from owners, as described in paragraphs 37–38.

87. Revenue arising from debt forgiveness is measured at the carrying amount of the debt forgiven.

Fines

88. Fines are economic benefits or service potential received or receivable by a public sector entity, from an individual or other entity, as determined by a court or other law enforcement body, as a consequence of the individual or other entity breaching the requirements of laws or regulations. In some jurisdictions, law enforcement officials are able to impose fines on individuals considered to have breached the law. In these cases, the individual will

normally have the choice of paying the fine, or going to court to defend the matter. Where a defendant reaches an agreement with a prosecutor that includes the payment of a penalty instead of being tried in court, the payment is recognized as a fine.

89. Fines normally require an entity to transfer a fixed amount of cash to the government, and do not impose on the government any obligations which may be recognized as a liability. As such, fines are recognized as revenue when the receivable meets the definition of an asset and satisfies the criteria for recognition as an asset set out in paragraph 31. As noted in paragraph 12, where an entity collects fines in the capacity of an agent, the fine will not be revenue of the collecting entity. Assets arising from fines are measured at the best estimate of the inflow of resources to the entity.

Bequests

90. A bequest is a transfer made according to the provisions of a deceased person's will. The past event giving rise to the control of resources embodying future economic benefits or service potential for a bequest occurs when the entity has an enforceable claim, for example on the death of the testator, or the granting of probate, depending on the laws of the jurisdiction.

91. Bequests that satisfy the definition of an asset are recognized as assets and revenue when it is probable that the future economic benefits or service potential will flow to the entity, and the fair value of the assets can be measured reliably. Determining the probability of an inflow of future economic benefits or service potential may be problematic if a period of time elapses between the death of the testator and the entity receiving any assets. The entity will need to determine if the deceased person's estate is sufficient to meet all claims on it, and satisfy all bequests. If the will is disputed, this will also affect the probability of assets flowing to the entity.

92. The fair value of bequeathed assets is determined in the same manner as for gifts and donations, as is described in paragraph 97. In jurisdictions where deceased estates are subject to taxation, the tax authority may already have determined the fair value of the asset bequeathed to the entity, and this amount may be available to the entity. Bequests are measured at the fair value of the resources received or receivable.

Gifts and Donations, including Goods In-kind

93. Gifts and donations are voluntary transfers of assets, including cash or other monetary assets, goods in-kind, and services in-kind that one entity makes to another, normally free from stipulations. The transferor may be an entity or an individual. For gifts and donations of cash or other monetary assets and goods in-kind, the past event giving rise to the control of resources embodying future economic benefits or service potential is normally the receipt of the gift or

donation. Recognition of gifts or donations of services in-kind are addressed in paragraphs 98–103 below.

94. Goods in-kind are tangible assets transferred to an entity in a non-exchange transaction, without charge, but may be subject to stipulations. External assistance provided by multilateral or bilateral development organizations often includes a component of goods in-kind.

95. Gifts and donations (other than services in-kind) are recognized as assets and revenue when it is probable that the future economic benefits or service potential will flow to the entity and the fair value of the assets can be measured reliably. With gifts and donations, the making of the gift or donation and the transfer of legal title are often simultaneous; in such circumstances, there is no doubt as to the future economic benefits flowing to the entity.

96. Goods in-kind are recognized as assets when the goods are received, or there is a binding arrangement to receive the goods. If goods in-kind are received without conditions attached, revenue is recognized immediately. If conditions are attached, a liability is recognized, which is reduced and revenue recognized as the conditions are satisfied.

97. On initial recognition, gifts and donations including goods in-kind are measured at their fair value as at the date of acquisition, which may be ascertained by reference to an active market, or 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.

Services In-kind

98. **An entity may, but is not required to, recognize services in-kind as revenue and as an asset.**

99. Services in-kind are services provided by individuals to public sector entities in a non-exchange transaction. These services meet the definition of an asset because the entity controls a resource from which future economic benefits or service potential are expected to flow to the entity. These assets are, however, immediately consumed, and a transaction of equal value is also recognized to reflect the consumption of these services in-kind. For example, a public school that receives volunteer services from teachers' aides, the fair value of which can be reliably measured, may recognize an increase in an asset and revenue, and a decrease in an asset and an expense. In many cases, the entity will recognize an expense for the consumption of services in-kind. However, services in-kind may also be utilized to construct an asset, in which case the

amount recognized in respect of services in-kind is included in the cost of the asset being constructed.

100. Public sector entities may be recipients of services in-kind under voluntary or non-voluntary schemes operated in the public interest. For example:

(a) Technical assistance from other governments or international organizations;

(b) Persons convicted of offenses may be required to perform community service for a public sector entity;

(c) Public hospitals may receive the services of volunteers;

(d) Public schools may receive voluntary services from parents as teachers' aides or as board members; and

(e) Local governments may receive the services of volunteer fire fighters.

101. Some services in-kind do not meet the definition of an asset because the entity has insufficient control over the services provided. In other circumstances, the entity may have control over the services in-kind, but may not be able to measure them reliably, and thus they fail to satisfy the criteria for recognition as an asset. Entities may, however, be able to measure the fair value of certain services in-kind, such as professional or other services in-kind that are otherwise readily available in the national or international marketplace. When determining the fair value of the types of services in-kind described in paragraph 100, the entity may conclude that the value of the services is not material. In many instances, services in-kind are rendered by persons with little or no training, and are fundamentally different from the services the entity would acquire if the services in-kind were not available.

102. Due to the many uncertainties surrounding services in-kind, including the ability to exercise control over the services, and measuring the fair value of the services, this Standard does not require the recognition of services in-kind. Paragraph 108, however, encourages the disclosure of the nature and type of services in-kind received during the reporting period. As for all disclosures, disclosures relating to services in-kind are only made if they are material. For some public sector entities, the services provided by volunteers are not material in amount, but may be material by nature.

103. In developing an accounting policy addressing a class of services in-kind, various factors would be considered, including the effects of those services in-kind on the financial position, performance, and cash flows of the entity. The extent to which an entity is dependent on a class of services in-kind to meet its objectives, may influence the accounting policy an entity develops regarding the recognition of assets. For example, an entity that is dependent on a class of services in-kind to meet its objectives, may be more likely to recognize those services in-kind that meet the definition of an asset and satisfy the criteria for

recognition. In determining whether to recognize a class of services in-kind, the practices of similar entities operating in a similar environment are also considered.

Pledges

104. Pledges are unenforceable undertakings to transfer assets to the recipient entity. Pledges do not meet the definition of an asset, because the recipient entity is unable to control the access of the transferor to the future economic benefits or service potential embodied in the item pledged. Entities do not recognize pledged items as assets or revenue. If the pledged item is subsequently transferred to the recipient entity, it is recognized as a gift or donation, in accordance with paragraphs 93–97 above. Pledges may warrant disclosure as contingent assets under the requirements of IPSAS 19.

Advance Receipts of Transfers

105. Where an entity receives resources before a transfer arrangement becomes binding, the resources are recognized as an asset when they meet the definition of an asset and satisfy the criteria for recognition as an asset. The entity will also recognize an advance receipt liability if the transfer arrangement is not yet binding. Advance receipts in respect of transfers are not fundamentally different from other advance receipts, so a liability is recognized until the event that makes the transfer arrangement binding occurs, and all other conditions under the agreement are fulfilled. When that event occurs and all other conditions under the agreement are fulfilled, the liability is discharged and revenue is recognized.

Concessionary Loans

105A. Concessionary loans are loans received by an entity at below market terms. The portion of the loan that is repayable, along with any interest payments, is an exchange transaction and is accounted for in accordance with IPSAS 29, *Financial Instruments: Recognition and Measurement*. An entity considers whether any difference between the transaction price (loan proceeds) and the fair value of the loan on initial recognition (see IPSAS 29) is non-exchange revenue that should be accounted for in accordance with this Standard.

105B. Where an entity determines that the difference between the transaction price (loan proceeds) and the fair value of the loan on initial recognition is non-exchange revenue, an entity recognizes the difference as revenue, except if a present obligation exists, e.g., where specific conditions imposed on the transferred assets by the recipient result in a present obligation. Where a present obligation exists, it is recognized as a liability. As the entity satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognized.

Disclosures

106. **An entity shall disclose either on the face of, or in the notes to, the general purpose financial statements:**

(a) **The amount of revenue from non-exchange transactions recognized during the period by major classes showing separately:**

(i) **Taxes, showing separately major classes of taxes; and**

(ii) **Transfers, showing separately major classes of transfer revenue.**

(b) **The amount of receivables recognized in respect of non-exchange revenue;**

(c) **The amount of liabilities recognized in respect of transferred assets subject to conditions;**

(cA) **The amount of liabilities recognized in respect of concessionary loans that are subject to conditions on transferred assets;**

(d) **The amount of assets recognized that are subject to restrictions and the nature of those restrictions;**

(e) **The existence and amounts of any advance receipts in respect of non-exchange transactions; and**

(f) **The amount of any liabilities forgiven.**

107. **An entity shall disclose in the notes to the general purpose financial statements:**

(a) **The accounting policies adopted for the recognition of revenue from non-exchange transactions;**

(b) **For major classes of revenue from non-exchange transactions, the basis on which the fair value of inflowing resources was measured;**

(c) **For major classes of taxation revenue that the entity cannot measure reliably during the period in which the taxable event occurs, information about the nature of the tax; and**

(d) **The nature and type of major classes of bequests, gifts, and donations, showing separately major classes of goods in-kind received.**

108. Entities are encouraged to disclose the nature and type of major classes of services in-kind received, including those not recognized. The extent to which an entity is dependent on a class of services in-kind will determine the disclosures it makes in respect of that class.

109. The disclosures required by paragraphs 106 and 107 assist the reporting entity to satisfy the objectives of financial reporting, as set out in IPSAS 1, which is

to provide information useful for decision making, and to demonstrate the accountability of the entity for the resources entrusted to it.

110. Disclosure of the major classes of revenue assists users to make informed judgments about the entity's exposure to particular revenue streams.

111. Conditions and restrictions impose limits on the use of assets, which impacts the operations of the entity. Disclosure of (a) the amount of liabilities recognized in respect of conditions, and (b) the amount of assets subject to restrictions assists users in making judgments about the ability of the entity to use its assets at its own discretion. Entities are encouraged to disaggregate by class the information required to be disclosed by paragraph 106(c).

112. Paragraph 106(e) requires entities to disclose the existence of advance receipts in respect of non-exchange transactions. These liabilities carry the risk that the entity will have to make a sacrifice of future economic benefits or service potential if the taxable event does not occur, or a transfer arrangement does not become binding. Disclosure of these advance receipts assists users to make judgments about the entity's future revenue and net asset position.

113. As noted in paragraph 68, in many cases an entity will be able to reliably measure assets and revenue arising from taxation transactions, using, for example, statistical models. However, there may be exceptional circumstances where an entity is unable to reliably measure the assets and revenue arising until one or more reporting periods has elapsed since the taxable event occurred. In these cases, the entity makes disclosures about the nature of major classes of taxation that cannot be reliably measured, and therefore recognized, during the reporting period in which the taxable event occurs. These disclosures assist users to make informed judgments about the entity's future revenue and net asset position.

114. Paragraph 107(d) requires entities to make disclosures about the nature and type of major classes of gifts, donations, and bequests it has received. These inflows of resources are received at the discretion of the transferor, which exposes the entity to the risk that, in future periods, such sources of resources may change significantly. Such disclosures assist users to make informed judgments about the entity's future revenue and net asset position.

115. Where services in-kind meet the definition of an asset and satisfy the criteria for recognition as an asset, entities may elect to recognize these services in-kind and measure them at their fair value. Paragraph 108 encourages an entity to make disclosures about the nature and type of all services in-kind received, whether they are recognized or not. Such disclosures may assist users to make informed judgments about (a) the contribution made by such services to the achievement of the entity's objectives during the reporting period, and (b)the entity's dependence on such services for the achievement of its objectives in the future.

Transitional Provisions

116. [Deleted]

117. [Deleted]

118. [Deleted]

119. [Deleted]

120. [Deleted]

121. [Deleted]

122. [Deleted]

123. [Deleted]

Effective Date

124. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after June 30, 2008. Earlier application is encouraged. If an entity applies this Standard for periods beginning before June 30, 2008, it shall disclose that fact.**

124A. **IPSAS 28 amended paragraph 37. An entity shall apply the amendment for annual financial statements covering periods beginning on or after January 1, 2013. If an entity applies IPSAS 28 for a period beginning before January 1, 2013, the amendment shall also be applied for that earlier period.**

124B. **IPSAS 29 amended paragraphs 5, 10, 87, and 106, and inserted paragraphs 105A and 105B. An entity shall apply the amendments for annual financial statements covering periods beginning on or after January 1, 2013. If an entity applies IPSAS 29 for a period beginning before January 1, 2013, the amendments shall also be applied for that earlier period.**

124C. **Paragraphs 116, 117, 118, 119, 120, 121, 122, 123 and 125 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

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

statements covering periods beginning on or after the date of adoption of IPSASs.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 23.

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 23. Individual IPSASB members gave greater weight to some factors than to others. In forming their views, IPSASB members considered in depth (a) the views expressed by the Steering Committee on Non-Exchange Revenue in the Invitation to Comment (ITC), *Revenue from Non-Exchange Transactions (Including Taxes and Transfers)*, issued in January 2004, (b) the views expressed by constituents who responded to the consultation on that ITC, and (c) the views of respondents to Exposure Draft (ED) 29, *Revenue from Non-Exchange Transactions (Including Taxes and Transfers)*.

BC2. In developing this IPSAS, the IPSASB considered the provisions of relevant IFRSs issued by the IASB, in particular International Accounting Standards (IAS) 20, *Accounting for Government Grants and Disclosure of Government Assistance*, and IAS 41, *Agriculture*.

BC3. The IPSASB is cognizant of the project being undertaken by the IASB on revenue recognition and also the IASB's ED Proposed Amendments to IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*. The IPSASB will continue to monitor these projects and, at an appropriate time, consider implications of any changes to IFRSs for IPSASs and IPSASB projects. However, the IPSASB does not consider it appropriate to preempt the outcome of the IASB's due process and anticipate changes to IFRSs. In addition, given the significance of non-exchange revenue to many public sector entities, the IPSASB does not consider that it would be appropriate to defer issuance of this IPSAS pending the outcome of IASB projects.

Background

BC4. Governments and many other public sector entities derive the majority of their revenue from non-exchange transactions. These transactions include, principally, taxation, but also transfers. This IPSAS addresses these types of transactions from the perspective of a public sector entity.

BC5. In 2002, the IPSASB (then the PSC) initiated a project to develop an IPSAS for the recognition and measurement of revenue from non-exchange transactions (including taxes and transfers). The IPSASB established a Steering Committee to develop an ITC to consider the issues related to this issue and make initial recommendations. The Steering Committee was comprised of public sector financial reporting experts from a variety of countries, and was chaired by an IPSASB member. An ITC was published in January 2004, with comments requested by June 30, 2004. Fifty-one comments were received. In November 2004, the IPSASB analyzed those comments and began drafting ED 29, which was published in January 2006, with a request for comments by June 30, 2006.

BC6. In November 2006, the IPSASB undertook an in-depth analysis of the responses to ED 29 and prepared this IPSAS and approved it for issue.

Approach

BC7. This Standard establishes broad principles for the recognition of revenue from non-exchange transactions, and provides guidance on the application of those principles to the major sources of revenue for governments and other public sector entities. In developing this Standard, the IPSASB considered whether to adopt an approach that focused on the development of requirements for accounting for revenue arising from a range of specific types of non-exchange transactions. However, the IPSASB noted and agreed with the views of the Steering Committee that such an approach brings with it consequent risks that the resultant Standard would not provide comprehensive guidance for all revenue from non-exchange transactions. The IPSASB is of the view that the approach adopted in this Standard ensures that appropriate broad principles for the recognition of revenue from non-exchange transactions are established and can be applied to all revenue from non-exchange transactions.

Entity Combinations

BC8. This Standard does not specify whether entity combinations resulting from non-exchange transactions will give rise to revenue. This is because the IPSASB has not considered the financial reporting of entity combinations in the public sector, including the applicability of IFRS 3, *Business Combinations*, to public sector entities.

Monetary and Non-monetary Assets

BC9. This Standard does not establish different requirements in respect of revenue received or receivable as monetary assets and revenue received or receivable as non-monetary assets. The IPSASB is of the view that while non-monetary assets raise additional measurement concerns, they do not, of themselves, justify different financial reporting treatments.

Enforceability of Stipulations

BC10. This Standard defines stipulations, conditions, and restrictions as terms in a transfer agreement or legislation or other binding arrangements imposed upon the use of transferred assets. The Standard reflects the view that stipulations, conditions, and restrictions must be enforceable to be effective. The ITC and ED 29 also reflected the principle that stipulations imposed on the use of transferred assets are contained in laws, regulations, or other binding arrangements, and are by definition enforceable. The IPSASB considers that this principle is necessary to prevent the inappropriate deferment of revenue recognition, or the disclosure of restrictions that have no substance.

Stipulations—Conditions

BC11. This Standard requires that where the transfer of an asset imposes a condition on the recipient, the recipient should recognize a liability in respect of the transfer on initial recognition of the asset. This is because the recipient is unable to avoid an outflow of resources, as it is required to consume the future economic benefits or service potential embodied in the transferred asset in the delivery of particular goods or services to third parties as specified, or else to return to the transferor future economic benefits or service potential. Depending on the nature of the condition, it may be fulfilled progressively, permitting the entity to reduce the amount of the liability and recognize revenue progressively, or it may only be fulfilled on the occurrence of a particular future event, in which case the entity eliminates the liability and recognizes revenue when that event occurs.

BC12. Some are of the view that a liability should be recognized only when it is probable that conditions attaching to the inflow of resources will not be satisfied, and that future economic benefits or service potential will be required to be returned to the transferor. The IPSASB rejected this proposal, because it could result in entities recognizing revenue prematurely, because the entity would recognize the full fair value of the asset as revenue when it initially gains control of the asset, notwithstanding the outflow of resources necessary to satisfy the condition. The financial statements would not, therefore, recognize the present obligation to fulfill the condition imposed by the transfer or return future economic benefits or service potential to the transferor.

Stipulations—Restrictions

BC13. This Standard does not permit entities to recognize a liability in respect of a restriction when the transferred asset is initially recognized. This is because, as defined in this Standard, restrictions do not of themselves impose a present obligation upon the recipient entity to sacrifice future economic benefits or service potential to satisfy the restriction. A breach of a restriction may ultimately lead to a penalty, such as a fine, being imposed upon the recipient entity; however, such a penalty is the result of enforcement procedures resulting from the breach, not from the initial recognition of the asset.

Transactions with Exchange and Non-Exchange Components

BC14. This Standard notes that a single transaction can have two components, an exchange component and a non-exchange component. In these cases, the

IPSASB is of the view that the transaction's component parts should be distinguished and recognized separately. Distinguishing the component parts enhances the transparency of financial statements and satisfies the qualitative characteristic of reporting the substance of transactions.

Contributions from Owners

BC15. This Standard identifies examples of some types of documentation that may evidence contributions from owners in the public sector (paragraph 38). Many public sector entities receive inflows of resources from entities that control them, own them, or are members of them. In certain circumstances, the inflow of resources will be designated as a contribution from owners. Notwithstanding the documentation that evidences the form of the inflow of resources or its designation by a controlling entity, this Standard reflects the view that for an inflow of resources to be classified as a contribution from owners, the substance of the transaction must be consistent with that classification.

Measurement of Assets

BC16. This Standard requires that assets acquired through non-exchange transactions be initially measured at their fair value as at the date of acquisition. The IPSASB is of the view that this is appropriate to reflect the substance of the transaction and its consequences for the recipient. In an exchange transaction, the cost of acquisition is a measure of the fair value of the asset acquired. However, by definition, in a non-exchange transaction the consideration provided for the acquisition of an asset is not approximately equal to the fair value of the asset acquired. Fair value most faithfully represents the actual value the public sector entity accrues as a result of the transaction. Initial measurement of assets acquired through non-exchange transactions at their fair value is consistent with the approach taken in IPSAS 16, *Investment Property*, and IPSAS 17, *Property, Plant, and Equipment*, for assets acquired at no cost or for a nominal cost. The IPSASB has made consequential amendments to IPSAS 12, *Inventories*, and IPSAS 16 and IPSAS 17 to fully align those IPSASs with the requirements of this Standard.

Entity Bank Accounts

BC17. This Standard assumes the requirement that all money deposited in a bank account of an entity satisfies the definition of an asset and meets the criteria for recognition of an asset of the entity. The IPSASB established this principle in paragraphs 1.2.6 and 1.2.7 of the Cash Basis IPSAS, *Financial Reporting under the Cash Basis of Accounting*. The Standard also requires the recognition of a liability in respect of any amount the reporting entity has collected and deposited in its own bank account while acting as an agent of another entity.

Measurement of Liabilities

BC18. This Standard requires that where an entity recognizes a liability in respect of an inflow of resources, that liability will initially be measured as the best estimate of the amount required to settle the obligation at the reporting date. This measurement basis is consistent with IPSAS 19. The IPSASB is also cognizant of the amendments proposed for IAS 37 (to be retitled *Non-financial Liabilities*), on which IPSAS 19 is based, and will monitor, and in due course consider, its response to any developments in IAS 37.

Taxable Event

BC19. This Standard defines a taxable event as the past event that the government, legislature, or other authority has determined to be subject to taxation. The Standard notes that this is the earliest possible time to recognize assets and revenue arising from a taxation transaction, and is the point at which the past event that gives rise to control of the asset occurs. The IPSASB considered an alternative view that an entity only gains control of resources arising from taxation when those resources are received. While recognizing that there can be difficulties in reliably measuring certain taxation streams, the IPSASB rejected such an approach as inappropriate for the accrual basis of financial reporting.

Advance Receipts

BC20. This Standard requires an entity that receives resources in advance of the taxable event, or of a transfer arrangement becoming enforceable, to recognize an asset and a liability of an equivalent amount. This is consistent with the principles of accrual accounting to recognize revenue in the period in which the underlying event that gives rise to the revenue occurs. In the event that the taxable event did not occur, or the transfer arrangement did not become enforceable, the entity may need to return part or all of the resources. Some are of the view that, where resources are received in advance of the taxable event, an entity should only recognize a liability where it considers it probable that there will be a subsequent outflow of resources. The IPSASB supports the view that revenue should not be recognized until the taxable event occurs, and extends the principle to transfers, so that where resources are received prior to a transfer arrangement becoming binding, the entity recognizes an asset and a liability for the advance receipt.

Expenses Paid Through the Tax System and Tax Expenditures

BC21. This Standard requires that expenses paid through the tax system be distinguished from tax expenditures, and that the former should be recognized separately from revenue in the general purpose financial statements. This is because, as defined in this Standard, expenses paid through the tax system satisfy the definition of expenses and, according to the principles established in IPSAS 1, offsetting of expenses against revenue is not permitted. As defined in this Standard, tax expenditures are one of the many factors used to determine the amount of tax revenue received or receivable and are not recognized separately from revenue. The IPSASB is of the view that this treatment is consistent with the principles established in this Standard.

BC22. The treatment prescribed in this Standard for expenses paid through the tax system is different to that currently prescribed by the Organization for Economic Co-operation and Development (OECD) for member country statistical returns. The OECD currently requires tax revenue to be shown net of expenses paid through the tax system (or non-wastable tax credits) to the extent that an individual taxpayer's liability for tax is reduced to zero, payments to a taxpayer are shown as expenses.[1] The IPSASB is of the view that the current OECD treatment does not conform to the conceptual principles underpinning the IPSASs and the IPSAS 1 requirement not to offset items of revenue and expense. The statistical financial reporting frameworks are currently under review; in particular, a new edition of the United Nations' *System of National Accounts* is currently under development and is due to be published in 2008. The revised framework may revise the current reporting requirement in respect to tax credits. Revision of the *System of National Accounts* often precedes revisions to other statistical frameworks.

The Tax Gap

BC23. For some taxes, reporting entities will be aware that the amount the government is entitled to collect under the tax law is higher than the amount that will be collected, but will not be able to reliably measure the amount of this difference. The amount collected is lower due to the underground economy (or black market), fraud, evasion, noncompliance with the tax law, and error. The difference between what is legally due under the law and what the government will be able to collect is referred to as the tax gap. Amounts previously included in tax revenue that are determined as not collectible do not constitute part of the tax gap.

BC24. The IPSASB is of the view that the tax gap does not meet the definition of an asset, as it is not expected that resources will flow to the government in respect of these amounts. Consequently, assets, liabilities, revenue, or expenses will not be recognized in respect of the tax gap.

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[1] OECD, *Revenue Statistics* (Paris: OECD, 2000): p. 267, §20-21.

Services In-kind

BC25. This Standard permits, but does not require, recognition of services in kind. This Standard takes the view that many services in-kind do meet the definition of an asset and should, in principle, be recognized. In such cases there may, however, be difficulties in obtaining reliable measurements. In other cases, services in-kind do not meet the definition of an asset because the reporting entity has insufficient control of the services provided. The IPSASB concluded that due to difficulties related to measurement and control, recognition of services in-kind should be permitted but not required.

Compulsory Contributions to Social Security Schemes

BC26. This Standard does not exclude from its scope compulsory contributions to social security schemes that are non-exchange transactions. There are a variety of different arrangements for funding social security schemes in different jurisdictions. Whether or not compulsory contributions to social security schemes give rise to exchange or non-exchange transactions depends on the particular arrangements of a given scheme, and professional judgment is exercised to determine whether the contributions to a social security scheme are recognized in accordance with the principles established in this Standard, or in accordance with principles established in international or national standards addressing such schemes.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 23.

Measurement, Recognition, and Disclosure of Revenue from Non-Exchange Transactions

Income Tax (paragraph 65)

IG1. A national government (reporting entity) imposes a 25 percent tax on personal income earned within the country. Employers are required to withhold taxes from payroll and remit withholdings on a monthly basis. Individuals with significant non-salary (for example, investment) income are required to make estimated tax payments on a quarterly basis. In addition, individuals must file a tax return with the taxation department by April 15 of the year following the tax year (calendar year), and must pay the remaining tax owed (or claim a refund) at that time. The government's reporting period ends on June 30.

IG2. The government controls a resource – income tax receivable – when the taxable event occurs, which is the earning of assessable income by taxpayers. At the end of the reporting period, the government recognizes assets and revenue in respect of personal income tax on the income earned during the reporting period, to the extent that it can reliably measure it. Assets and revenue will also be recognized in respect of income taxes on income earned in prior periods, but which did not meet the definition of, or satisfy the criteria for recognition as, an asset until the current reporting period.

Measurement of Taxation Revenue (paragraphs 67–70)

IG3. A national government (reporting entity) levies income tax on the personal income of all persons earning income within its jurisdiction. The tax was first levied some seventy years before the current reporting period, and taxation statistics are available for the entire seventy-year period. The tax year and the reporting period are January 1 to December 31. Taxpayers have until April 30 each year to file their tax return, and until June 30 to pay any outstanding taxes. The government is required by legislation to present audited consolidated general purpose financial statements to the legislature no later than March 31.

IG4. Income tax revenue should be recognized in the reporting period in which the taxable event occurred, that is, the earning of taxable income. As the tax administration system does not enable the government to directly measure income tax receivable until after its general purpose financial statements are issued, the government develops a model to indirectly measure income taxation revenue receivable. The government uses the income tax collection history it has in the taxation statistics, which it compares to other observable phenomena to develop a reliable model. Other phenomena can include other economic statistics, such as gross domestic product, financial phenomena such as income tax installments deducted by employers, sales tax collections (if it levies such a tax), and banking statistics collected by the central bank. This government may enlist the assistance of econometricians in developing the model, and the external auditor tests the validity of the model in accordance with international and national auditing standards.

IG5. The model enables the reporting entity to reliably measure the assets and revenue accruing to it during the reporting period, which are then recognized and disclosed in the general purpose financial statements. The notes to the general purpose financial statements disclose the accounting policies, including the basis of measurement of income tax revenue. In these circumstances, estimates of tax revenue for one reporting period may be revised in a subsequent period. Changes in estimates are recognized prospectively in accordance with IPSAS 3.

Value Added Tax (paragraph 65)[1]

IG6. A national government (reporting entity) imposes a value-added tax (VAT) on all businesses. The tax is 15 percent of the value added and is collected by merchants from customers (taxpayers) at the time of sale. Large and medium-sized businesses are required to submit VAT returns electronically to the tax department on a weekly basis; however, small businesses are permitted to submit VAT returns manually on a quarterly basis.

IG7. The government controls a resource – VAT receivable – when the taxable event occurs, which is the undertaking of taxable activity, that is, the sale of value-added goods or services, during the reporting period. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which the taxable activity takes place, or later, as soon as it can reliably measure the tax receivable. In many circumstances, the taxation return period will not coincide with the reporting period. In these circumstances, estimates of tax revenue for the reporting period may be revised in a subsequent period. Changes in estimates are recognized prospectively in accordance with IPSAS 3.

Goods and Services Tax (paragraph 65)

IG8. A national government (reporting entity) imposes a goods and services tax (GST) on sales of goods and services. The tax is 10 percent of the value of goods and services sold. Most sellers of goods and services are required to electronically submit GST returns to the tax department on a weekly basis. However, small businesses are permitted to manually submit GST returns on a quarterly basis.

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1 Some jurisdictions use the terms Value Added Tax (VAT) and Goods and Services Tax (GST) interchangeably.

IG9. The government controls a resource – GST receivable – when the taxable event occurs, which is the sale of taxable goods and services during the reporting period. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which the sales and purchases take place or, if the tax receivable cannot be reliably measured as at the end of the reporting period, later, as soon as it can reliably measure the tax receivable.

Customs Duty (paragraph 65)

IG10. A national government (reporting entity) imposes customs duty on all imports of goods. The duties vary depending on the type of goods imported, and are set at levels to ensure that domestically produced goods are cheaper in the retail market. Imported goods are held in bonded warehouses until the importer pays the duty. Importers are required to make import declarations to the customs department and pay the duty immediately. Most importers submit these declarations electronically before the goods arrive, and make electronic funds transfers to the customs department when the goods are unloaded from ships or aircraft, or as trains or trucks pass the customs boundary.

IG11. The government controls a resource – duty receivable – when the taxable event occurs, which is the movement of goods across the customs boundary. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which the goods move across the boundary, or later, as soon as it can reliably measure the duty receivable.

Death Duties (paragraph 65)

IG12. A national government (reporting entity) imposes death duties of 40 percent on all estates valued at more than 500,000 currency units (CU). Medical practitioners and funeral directors are required to notify the tax department of all deaths. An assessor then makes an interim valuation of the estate to determine whether duty will be payable. Executors of estates are required to file an inventory of the estate with the tax department, which values the estate and determines the duty due from the estate. Probate cannot be granted until all duty is paid. Due to complexities in testamentary law and frequent appeals of valuations, it takes on average four years to settle estates and collect the duty due.

IG13. The government controls a resource – death duties receivable – when the taxable event occurs, which is the death of a person owning taxable property. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which the person dies, or later, as soon as it can reliably measure the assets.

Property Tax (paragraph 65)

IG14. A local government (reporting entity) levies a tax of one percent of the assessed value of all property within its jurisdiction. The government's reporting period is July 1 to June 30. The tax is levied on July 31, with notices of assessment being sent to property owners in July, and payment due by August 31. If taxes are unpaid on that date, property owners incur penalty interest rate payments of three percent per month of the amount outstanding. The tax law permits the government to seize and sell a property to collect outstanding taxes.

IG15. The government controls a resource – property taxes receivable – when the taxable event occurs, which is the passing of the date on which the taxes are levied, July 31. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which that date occurs.

Advance Receipts of Income Tax (paragraph 66)

IG16. Government A (reporting entity) levies income tax on all residents within its jurisdiction. The tax period and the reporting period are January 1 to December 31. Self-employed taxpayers are required to pay an estimate of their income tax for the year by December 24 of the year immediately preceding the commencement of the tax year. The tax law sets the estimate as the amount due for the most recently completed assessment, plus one tenth, unless the taxpayer provides an explanation prior to December 24 of a lower amount (penalties apply if the taxpayer's assessment proves to be materially lower than the final amount owed). After the end of the tax period, self-employed taxpayers file their tax returns and receive refunds, or pay additional tax to the government.

IG17. The resources received from self-employed taxpayers by December 24 are advance receipts against taxes due for the following year. The taxable event is the earning of income during the taxation period, which has not commenced. The reporting entity recognizes an increase in an asset (cash in bank) and an increase in a liability (advance receipts).

Grant to Another Level of Government for General Purposes (paragraphs 14–16, 76)

IG18. The national government (transferor) makes a grant of CU10 million to a local government in a socioeconomically deprived area. The local government (reporting entity) is required under its constitution to undertake various social programs; however, it has insufficient resources to undertake all of these programs without assistance. There are no stipulations attached to the grant. All local governments are required to prepare and present audited general purpose financial statements.

IG19. There are no stipulations attached to these grants, and no performance obligation, so the transfers are recognized as assets and revenue in the general purpose financial statements of the reporting period in which they are received or receivable by the local government.

Transfer with Stipulations that do not Satisfy the Definition of a Condition (paragraphs 20–25)

IG20. A national government makes a cash transfer of CU50 million to a state government social housing entity, specifying that it:

(a) Increases the stock of social housing by an additional 1,000 units over and above any other planned increases; or

(b) Uses the cash transfer in other ways to support its social housing objectives.

If neither of these stipulations is satisfied, the recipient entity must return the cash to the national government.

IG21. The state government social housing entity recognizes an increase in an asset (cash) and revenue in the amount of CU50 million. The stipulations in the transfer agreement are stated so broadly as to not impose on the recipient a performance obligation – the performance obligation is imposed by the operating mandate of the entity, not by the terms of the transfer.

Transfer to a Public Sector University with Restrictions (paragraphs 19 and 76)

IG22. The national government (transferor) transfers 200 hectares of land in a major city to a university (reporting entity) for the establishment of a university campus. The transfer agreement specifies that the land is to be used for a campus, but does not specify that the land is to be returned if not used for a campus.

IG23. The university recognizes the land as an asset in the statement of financial position of the reporting period in which it obtains control of that land. The land should be recognized at its fair value in accordance with IPSAS 17. The restriction does not meet the definition of a liability or satisfy the criteria for recognition as a liability. Therefore, the university recognizes revenue in respect of the land in the statement of financial performance of the reporting period in which the land is recognized as an asset.

Grant to Another Level of Government with Conditions (paragraphs 17–18)

IG24. The national government (transferor) grants CU10 million to a provincial government (reporting entity) to be used to improve and maintain mass transit systems. Specifically, the money is required to be used as follows: 40 percent for existing railroad and tramway system modernization, 40 percent for new railroad or tramway systems, and 20 percent for rolling stock purchases and improvements. Under the terms of the grant, the money can only be used as stipulated, and the provincial government is required to include a note in its audited general purpose financial statements detailing how the grant money was spent. The agreement requires the grant to be spent as specified in the current year or be returned to the national government.

IG25. The provincial government recognizes the grant money as an asset. The provincial government also recognizes a liability in respect of the condition attached to the grant. As the province satisfies the condition, that is, as it makes authorized expenditures, it reduces the liability and recognizes revenue in the statement of financial performance of the reporting period in which the liability is discharged.

Research Grant (in Substance Exchange Transaction) (paragraph **8***)*

IG26. A large corporation that makes cleaning products (transferor) gives money to a public university (reporting entity) to conduct research on the effectiveness of a certain chemical compound in quickly removing graffiti. The corporation stipulates that the research results are to be shared with it before being announced to the public, and that it has the right to apply for a patent on the compound.

IG27. This is an exchange transaction. In return for the grant, the university provides research services and an intangible asset, the right (a future economic benefit) to profit from the research results. IPSAS 9 and IPSAS 31, *Intangible Assets* apply to this transaction.

Debt Forgiveness (paragraphs 84–87)

IG28. The national government (transferor) lent a local government (reporting entity) CU20 million to enable the local government to build a water treatment plant. After a change in policy, the national government decides to forgive the loan. There are no stipulations attached to the forgiveness of the loan. The national government writes to the local government and advises it of its decision; it also encloses the loan documentation, which has been annotated to the effect that the loan has been waived.

IG29. When it receives the letter and documentation from the national government, which communicates this decision, the local government derecognizes the liability for the loan and recognizes revenue in the statement of financial performance of the reporting period in which the liability is derecognized.

Purchase of Property with Exchange and Non-Exchange Components (paragraphs **8***–11, 39–41)*

IG30. A public school (reporting entity) purchases land with a fair value of CU100,000 for CU50,000 from a local government. The reporting entity concludes that the non-exchange transaction comprises two components, an exchange component and a non-exchange component. One component involves the purchase of a half share in the land for CU50,000, the other component is a non-exchange transaction that transfers the remaining half share of the land to the school.

IG31. In its general purpose financial statements for the reporting period in which the transaction takes place, the public school recognizes the land at CU100,000, (a cost of CU50,000 and a transfer of CU50,000), a reduction in its asset cash of CU50,000, and revenue from a non-exchange transaction of CU50,000 (the fair value of the increase in net assets recognized).

Proposed Bequest (paragraphs 90–92)

IG32. A 25-year old recent graduate (transferor) of a public university names the university (reporting entity) as the primary beneficiary in her will. This is communicated to the university. The graduate is unmarried and childless and has an estate currently valued at CU500,000.

IG33. The public university does not recognize any asset or revenue in its general purpose financial statements for the period in which the will is made. The past event for a bequest is the death of the testator (transferor), which has not occurred.

Pledge—Television Appeal for Public Hospital (paragraph 104)

IG34. On the evening of June 30, 20X5, a local television station conducts a fundraising appeal for a public hospital (reporting entity). The annual reporting date of the public hospital is June 30. Television viewers telephone or e-mail, promising to send donations of specified amounts of money. At the conclusion of the appeal, CU2 million has been pledged. The pledged donations are not binding on those making the pledge. Experience with previous appeals indicates approximately 75 percent of pledged donations will be made.

IG35. The public hospital does not recognize any amount in its general purpose financial statements in respect of the pledges. The entity does not control the resources related to the pledge, because it cannot exclude or regulate the access of the prospective transferors to the economic benefits or service potential of the pledged resources; therefore it cannot recognize the asset or the related revenue until the donation is binding on the donor.

Fine (paragraphs 88–89)

IG36. A major corporation is found guilty of polluting a river. As a penalty, it is required to clean up the pollution and to pay a fine of CU50 million. The company is in sound financial condition and is capable of paying the fine. The company has announced that it will not appeal the case.

IG37. The government (reporting entity) recognizes a receivable and revenue of CU50 million in the general purpose financial statements of the reporting period in which the fine is imposed.

External Assistance Recognized (paragraphs 76–82)

IG38. National Government A (reporting entity) enters into an external assistance agreement with National Government B, which provides National Government A with development assistance grants to support National Government A's health objectives over a two-year period. The external assistance agreement is binding on both parties. The agreement specifies the details of the development assistance receivable by National Government A. Government A measures the fair value of the development assistance at CU5 million.

IG39. When the external assistance agreement becomes binding, National Government A recognizes an asset (a receivable) for the amount of CU5 million, and revenue in the same amount. The resources meet the definition of an asset and satisfy the recognition criteria when the agreement becomes binding. There are no conditions attached to this agreement that require the entity to recognize a liability.

Revenue of Aid Agency (paragraphs 76, 93–97)

IG40. Green-Aid Agency relies on funding from a group of governments. The governments have signed a formal agreement, which determines the percentage of Green-Aid Agency's approved budget that each government will fund. Green-Aid Agency can only use the funds to meet the expenses of the budget year for which the funds are provided. Green-Aid Agency's financial year begins on January 1. Green-Aid Agency's budget is approved in the preceding October, and the invoices are mailed out to the individual governments ten days after the budget is approved. Some governments pay before the start of the financial year and some during the financial year. However, based on past experience, some governments are very unlikely to pay what they owe, either during the financial year or at any future time.

IG41. For the budget year 20X8, the profile of amounts and timing of payments was as follows:

	(CU Million)
Budget approved October 24, 20X7	55
Amount invoiced November 4, 20X7	55
Transfers received as at December 31, 20X7	15
Transfers received during 20X8	38
Amount not received by December 31, 20X8 and unlikely to be received	2

IG42. In 20X7, Green-Aid Agency recognizes an asset of CU15 Million for the amount of transfers received before the start of 20X8, because it has control over an asset when the transfer is received and deposited in its bank account. An equivalent CU15 Million liability, revenue received in advance, is recognized.

IG43. In 20X8, Green Aid Agency recognizes CU53 million of revenue from transfers. In the notes to its general purpose financial statements, it discloses that CU55 Million was invoiced and an allowance for doubtful debts of CU2 Million was established.

Goods In-kind Recognized as Revenue (paragraphs 42, 93–97)

IG44. Transferor Government A has an arrangement with the public sector reporting entity, Aid Agency Inc., whereby Government A provides rice to meet its promised financial commitments to Aid Agency Inc. Based on the variability in Government A’s past performance in meeting its commitments, Aid Agency Inc. has adopted an accounting policy of not recognizing the asset and revenue until receipt of the promised rice. Government A promises to provide Aid Agency Inc. with CU300,000 during 20X5. Government A subsequently transfers 1,000 metric tons of rice to Aid Agency Inc. on January 12, 20X5. The transfer of the rice takes place in one of the ports of the transferor nation. According to the details of the funding agreement between Aid Agency Inc. and Government A, the rice is valued at the previously agreed amount of CU300 per ton, with the result that the transfer of 1,000 metric tons of rice fully discharges Government A’s financial commitment of CU300,000. During February and March 20X5, Aid Agency Inc. provides the rice to a network of local distribution agencies in Nations B and C in order to meet the needs of starving people.

IG45. On January 12, 20X5, the market price of 1,000 metric tons of rice was: CU280,000 in Government A’s nation; CU250,000 in the international commodities market; CU340,000 in recipient Nation B; and CU400,000 in recipient Nation C.

IG46. The fair value of the rice at the time of the donation must be determined to measure the revenue that Aid Agency Inc. recognizes. The financial agreement between the donor and the aid agency, which allows the rice to be valued at CU300 per metric ton, depends on a private agreement between the two parties, and does not necessarily reflect the fair value of the rice. Both Aid Agency Inc. and Donor Government A have the option of purchasing the rice on the world market at the lower price of CU250,000. The market prices for individual countries appear open to fluctuation – either as a result of trade barriers or, in the case of recipient countries, temporary distortions due to severe food shortages, and may not reflect a transfer between a knowledgeable willing buyer and a knowledgeable willing seller in an orderly market. Therefore, the world market price of CU250,000 is the most reliable and relevant reflection of fair value for the donated rice. Aid Agency Inc. recognizes an increase in an asset (rice inventory) and revenue of CU250,000 in its general purpose financial statements for the year in which the transfer is received.

Disclosure of Services In-kind not Recognized (paragraphs 98–102, 108)

IG47. A public hospital's (reporting entity) accounting policies are to recognize voluntary services received as assets and revenue when they meet the definition of an asset and satisfy the criteria for recognition as assets. The hospital enlists the services of volunteers as part of an organized program. The principal aim of the program is to expose volunteers to the hospital environment, and to promote nursing as a career. Volunteers must be at least sixteen years of age, and are initially required to make a six-month commitment to work one four-hour morning or afternoon shift per week. The first shift for each volunteer consists of a hospital orientation training session. Many local high schools permit students to undertake this work as part of their education program. Volunteers work under the direction of a registered nurse and perform non-nursing duties such as visiting patients and reading to patients. The public hospital does not pay the volunteers, nor would it engage employees to perform volunteers' work if volunteers were not available.

IG48. The hospital analyzes the agreements it has with the volunteers and concludes that, at least for a new volunteer's first six months, it has sufficient control over the services to be provided by the volunteer to satisfy the definition of control of an asset. The hospital also concludes that it receives service potential from the volunteers, satisfying the definition of an asset. However, it concludes that it cannot reliably measure the fair value of the services provided by the volunteers, because there are no equivalent paid positions either in the hospital or in other health or community care facilities in the region. The hospital does not recognize the services in-kind provided by the volunteers. The hospital discloses the number of hours of service provided by volunteers during the reporting period and a description of the services provided.

Contribution from Owners (paragraphs 37–38)

IG49. In 20X0 the neighboring cities of Altonae, Berolini and Cadomi form the Tri-Cities Electricity Generating Service (TCEGS) (reporting entity). The charter establishing TCEGS is binding on the city governments and provides for equal ownership, which can only be changed by agreement. The cities contribute CU25 million each to establish TCEGS. These contributions satisfy the definition of a contribution from owners, which the entity recognizes as such. The charter also provides for the cities to purchase the output of the TCEGS in proportion to their ownership. The purchase price is equal to the full costs of production. In 20X9, the city of Berolini gives approval for the construction of an aluminum smelter within the city, which will result in a doubling of the city's electricity demand. The three cities agree to amend the charter of TCEGS to permit Berolini to make a contribution from owners to enable the construction of additional generating capacity. After an independent valuation of TCEGS, the cities agree that Berolini may make a CU50 million contribution from owners and increase its ownership share to 49.9%, with Altonae and Cadomi retaining 25.05% each.

IG50. When the amendment to the charter becomes binding, TCEGS will recognize an increase in assets of CU50 million (cash or contribution from owners receivable) and a contribution from owners of CU50 million.

Grant Agreement Term not Requiring Recognition of a Liability (paragraphs 20–25)

IG51. National Park Department (reporting entity) of Country A receives a grant of CU500,000 from the bilateral aid agency of Country B. The grant agreement stipulates that the grant is required to be used to rehabilitate deforested areas of Country A's existing wilderness reserves, but if the money is not used for the stated purpose, it must be returned to Country B. The terms of the grant agreement are enforceable in the courts of Country A, and in international courts of justice. This is the thirteenth year that National Park Department has received a grant of this type from the same transferor. In prior years, the grant has not been used as stipulated, but has been used to acquire additional land adjacent to national parks for incorporation into the parks. National Park Department has not conducted any rehabilitation of deforested areas in the past thirteen years. Country B's bilateral aid agency is aware of the breach of the agreement term.

IG52. National Park Department analyzes the transaction and concludes that, although the terms of the grant agreement are enforceable, because the bilateral aid agency has not enforced the condition in the past, and given no indication that it ever would, the terms have the form of a stipulation and condition, but not the substance. National Park Department recognizes an increase in an asset (cash in bank) and grant revenue; it does not recognize a liability.

Disclosures Made in the Financial Statements of Government A (paragraphs 106–108)

IG53. For the year ended December 31, 20X2, Government A prepares and presents financial statements prepared in accordance with IPSASs for the first time. It makes the following disclosures in its financial statements:

Statement of Financial Performance

	20X2 (CU',000)	20X1 (CU',000)
Revenue from Non-Exchange Transactions		
Taxation Revenue		
Income Tax Revenue (notes 4 and 8)	XXX	XXX
Goods and Services Tax (note 5)	XXX	XXX
Estate Taxes (notes 6 and 9)	XX	XX
Transfer Revenue		
Transfers from Other Governments (note 7)	XXX	XXX
Gifts, Donations, Goods In-kind (note 13)	X	X
Services In-kind (notes 15 and 16)	X	X

Statement of Financial Position

Current Assets		
Cash at Bank	XX	XX
Taxes Receivable		
Goods and Services Taxes Receivable (note 5)	XX	XX
Transfers Receivable		
Transfers receivable from Other Governments (note 7)	X	X
Noncurrent Assets		
Land (note 11)	XXX	XXX
Plant and Equipment (notes 12 and 14)	XX	XX
Current Liabilities		
Liabilities recognized under transfer arrangements (note 10)	XX	XX
Advance Receipts		
Taxes	X	X
Transfers	X	X

Notes to the Financial Statements

Accounting Policies

Recognition of Revenue from Non-Exchange Transactions

1. Assets and revenue arising from taxation transactions are recognized in accordance with the requirements of IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. However, the Government takes advantage of the transitional provisions in that Standard in respect of income taxes and estate taxes.

   Apart from income taxes and estate taxes, assets and revenue arising from taxation transactions are recognized in the period in which the taxable event occurs, provided that the assets satisfy the definition of an asset and meet the criteria for recognition as an asset. Income taxes and estate taxes are recognized in the period in which payment for taxation is received (see notes 4 and 6).

2. Assets and revenue arising from transfer transactions are recognized in the period in which the transfer arrangement becomes binding, except for some services in-kind. The government recognizes only those services in-kind that are received as part of an organized program and for which it can determine a fair value by reference to market rates. Other services in-kind are not recognized.

3. Where a transfer is subject to conditions that, if unfulfilled, require the return of the transferred resources, the Government recognizes a liability until the condition is fulfilled.

Basis of Measurement of Major Classes of Revenue from Non-Exchange Transactions

Taxes

4. Income tax revenue is measured at the nominal value of cash, and cash equivalents, received during the reporting period. The Government is currently developing a statistical model for measuring income tax revenue on an accruals basis. This model uses taxation statistics compiled since 19X2 as well as other statistical information, including average weekly earnings, gross domestic product, and the consumer and producer price indexes. The Government anticipates that the model will enable it to reliably measure income tax revenue on an accruals basis for the reporting period ended December 31, 20X4. The Government does not recognize any amount in respect of income taxes receivable.

5. Assets and revenue accruing from goods and services tax are initially measured at the fair value of assets accruing to the government during the reporting period, principally cash, cash equivalents, and goods and services

tax receivable. The information is compiled from the goods and services tax returns submitted by taxpayers during the year and other amounts estimated to be due to the government. Taxpayers have a high compliance rate and a low error rate, using the electronic return system established in 20X0. The high compliance and low error rates have enabled the Government to develop a reliable statistical model for measuring the revenue accruing from the tax.

Goods and services taxes receivable is the estimate of the amount due from taxes attributable to the reporting period that remain unpaid at December 31, 20X2, less a provision for bad debts.

6. Estate tax of 40% is levied on all deceased estates; however, the first CU400,000 of each estate is exempt from the tax. Assets and revenue from estate taxes are measured at the nominal value of the cash received during the reporting period, or the fair value as at the date of acquisition of other assets received during the period, as determined by reference to market valuations or by independent appraisal by a member of the valuation profession.

Transfer Revenue

7. Assets and revenue recognized as a consequence of a transfer are measured at the fair value of the assets recognized as at the date of recognition. Monetary assets are measured at their nominal value unless the time value of money is material, in which case present value is used, calculated using a discount rate that reflects the risk inherent in holding the asset. Non-monetary assets are measured at their fair value, which is determined by reference to observable market values or by independent appraisal by a member of the valuation profession. Receivables are recognized when a binding transfer arrangement is in place, but cash or other assets have not been received.

Taxes not Reliably Measurable in the Period in which the Taxable Event Occurs

8. The Government is unable to directly measure the assets arising from income tax during the period in which all taxpayers earn income and is, therefore, taking advantage of the transitional provisions of IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*, to develop a model to indirectly measure taxation revenue in the period in which taxpayers earn income. The government estimates that it will be able to reliably measure income tax on an accruals basis using the model for the reporting period ending December 31, 20X4.

9. In respect of estate taxes, due to current high levels of noncompliance with the law, the government is unable to measure the amount of assets and revenue accruing in the period in which persons owning taxable property die. The government therefore recognizes estate taxes when it receives payment for the tax. The tax department is continuing work to develop a reliable method of measuring the assets receivable and revenue in the year in which the taxable event occurs.

Liabilities Recognized in Respect of Transfers

10. At December 31, 20X2, the Government recognized a liability of CUXX,000 related to a transfer to it conditional upon it building a public hospital. As at December 31, the Government had received a cash payment, however, construction of the hospital had not commenced, although tenders for construction were called for on November 30, 20X2.

Assets Subject to Restrictions

11. Land with a fair value of CUXX,000 was donated during 20X2, subject to the restriction that it be used for public health purposes and not be sold for 50 years. The land was acquired by the transferor at a public auction immediately prior to its transfer, and the auction price is the fair value.

12. Plant and equipment includes an amount of CUXX,000, which is the carrying amount of a painting donated in 19X2 to an art gallery controlled by the Government, and subject to the restriction that it not be sold for a period of 40 years. The painting is measured at its fair value, determined by independent appraisal.

Major Classes of Bequests, Gifts, Donations, and Goods In-Kind Received

13. Transfers are received in the form of gifts, donations and goods in-kind – most notably medical and school supplies (inventory), medical and school equipment, and works of art (classified as equipment). Gifts and donations are received primarily from private benefactors. Hospitals, schools, and art galleries controlled by the Government recognize these assets when control passes to them, usually on receipt of the resources, either cash or plant and equipment. The Government does not accept these transfers with either conditions or restrictions attached unless the value of the transfer exceeds CUXX,000.

14. During 20X2, as part of an external assistance agreement with Government C, computer equipment with a fair value of CUXX,000 was provided to the Government on condition that it be used by the education department or be returned to Government C.

Services In-kind

15. Hospitals controlled by the government received medical services in-kind from medical practitioners as part of the medical profession's organized volunteer program. These services in-kind are recognized as revenue and expenses in the statement of financial performance at their fair value, as determined by reference to the medical profession's published schedule of fees.

16. Hospitals, schools, and art galleries controlled by the government also received support from volunteers as part of organized programs for art gallery

greeters and guides, teachers' aides, and hospital visitor guides. These volunteers provide valuable support to these entities in achieving their objectives; however, the services provided cannot be reliably measured as there are no equivalent paid positions available in the local markets and, in the absence of volunteers, the services would not be provided. The government does not recognize these services in the statements of financial position or financial performance.

Concessionary Loans (paragraphs 105A to 105B)

IG54. An entity receives CU6 million funding from a multi-lateral development agency to build 10 schools over the next 5 years. The funding is provided on the following conditions:

- CU1 million of the funding need not be repaid, provided that the schools are built.
- CU5 million of the funding is to be repaid as follows:

  Year 1: no capital to be repaid

  Year 2: 10% of the capital to be repaid

  Year 3: 20% of the capital to be repaid

  Year 4: 30% of the capital to be repaid

  Year 5: 40% of the capital to be repaid

- Interest is charged at 5% per annum over the period of the loan (assume interest is paid annually in arrears). The market rate of interest for a similar loan is 10%.
- To the extent that schools have not been built, the funding provided should be returned to the donor (assume that the donor has effective monitoring systems in place and has a past history of requiring any unspent funds to be returned).
- The entity built the following schools over the period of the loan:

  Year 1: 1 school completed

  Year 2: 3 schools completed

  Year 3: 5 schools completed

  Year 4: 10 schools completed

Analysis

The entity has effectively received a grant of CU1 million and a loan of CU5 million (Note: An entity would consider whether the substance of the CU1 million is a contribution from owners or revenue; assume for purposes of this example that the CU1 million is revenue). It has also received an additional grant of CU784,550 (which is the difference between the proceeds of the loan of CU5 million and the present value of the contractual cash flows of the loan, discounted using the market related rate of interest of 10%).

The grant of CU1 million + CU784,550 is accounted for in accordance with this Standard and, the loan with its related contractual interest and capital payments, in accordance with IPSAS 29.

1. On initial recognition, the entity will recognize the following:

Dr		Bank	CU6,000,000	
	Cr	Loan		CU4,215,450
	Cr	Liability		CU1,784,550

2. Year 1: the entity will recognize the following:

Dr		Liability	CU178,455	
	Cr	Non-exchange revenue		CU178,455

(1/10 of the schools built X CU1,784,550)

(Note: The journal entries for the repayment of interest and capital and interest accruals, have not been reflected in this example as it is intended to illustrate the recognition of revenue arising from concessionary loans. Comprehensive examples are included in the Illustrative Examples to IPSAS 29).

3. Year 2: the entity will recognize the following (assuming that the entity subsequently measures the concessionary loan at amortized cost):

Dr		Liability	CU356,910	
	Cr	Non-exchange revenue		CU356,910

3/10 schools built X CU1,784,500 – CU178,455 already recognized)

4. Year 3: the entity will recognize the following:

Dr		Liability	CU356,910	
	Cr	Non-exchange revenue		CU356,910

(5/10 schools built X CU1,784,550 – CU535,365 already recognized)

5. Year 4: the entity will recognize the following:

Dr		Liability	CU892,275	
	Cr	Non-exchange revenue		CU892,275

(All schools built, CU1,784,550 – CU892,275)

If the concessionary loan was granted with no conditions, the entity would recognize the following on initial recognition:

Dr		Bank	CU6,000,000	
	Cr	Loan		CU4,215,450
	Cr	Non-exchange revenue		CU1,784,550

IPSAS 24—PRESENTATION OF BUDGET INFORMATION IN FINANCIAL STATEMENTS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 24, *Presentation of Budget Information in Financial Statements* was issued in December 2006.

Since then, IPSAS 24 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 24

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
54A	New	IPSAS 33 January 2015
55	Amended	IPSAS 33 January 2015

December 2006

IPSAS 24—PRESENTATION OF BUDGET INFORMATION IN FINANCIAL STATEMENTS

CONTENTS

International Public Sector Accounting Standard 24, *Presentation of Budget Information in Financial Statements*, is set out in paragraphs 1–55. All the paragraphs have equal authority. IPSAS 24 should be read in the context of its objective, the Basis for Conclusions, the *Preface to the International Public Sector Accounting Standards*, and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. This Standard requires a comparison of budget amounts and the actual amounts arising from execution of the budget to be included in the financial statements of entities that are required to, or elect to, make publicly available their approved budget(s), and for which they are, therefore, held publicly accountable. This Standard also requires disclosure of an explanation of the reasons for material differences between the budget and actual amounts. Compliance with the requirements of this Standard will ensure that public sector entities discharge their accountability obligations and enhance the transparency of their financial statements by demonstrating (a) compliance with the approved budget(s) for which they are held publicly accountable and (b) where the budget(s) and the financial statements are prepared on the same basis, their financial performance in achieving the budgeted results.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard.**

3. **This Standard applies to public sector entities, other than Government Business Enterprises, which are required or elect to make their approved budget(s) publicly available.**

4. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

5. This Standard does not require approved budgets to be made publicly available, nor does it require that the financial statements disclose information about, or make comparisons with, approved budgets that are not made publicly available.

6. In some cases, approved budgets will be compiled to encompass all the activities controlled by a public sector entity. In other cases, separate approved budgets may be required to be made publicly available for certain activities, groups of activities, or entities included in the financial statements of a government or other public sector entity. This may occur (a) where, for example, a government's financial statements encompass government agencies or programs that have operational autonomy and prepare their own budgets, or (b) where a budget is prepared only for the general government sector of the whole-of-government. This Standard applies to all entities that present financial statements when approved budgets for the entity, or components thereof, are made publicly available.

Definitions

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

<u>Accounting basis</u> means the accrual or cash basis of accounting as defined in the accrual basis IPSASs and the Cash Basis IPSAS.

<u>Annual budget</u> means an approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.

<u>Appropriation</u> is an authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority.

<u>Approved budget</u> means the expenditure authority derived from laws, appropriation bills, government ordinances, and other decisions related to the anticipated revenue or receipts for the budgetary period.

<u>Budgetary basis</u> means the accrual, cash, or other basis of accounting adopted in the budget that has been approved by the legislative body.

<u>Comparable basis</u> means the actual amounts presented on the same accounting basis, same classification basis, for the same entities, and for the same period as the approved budget.

<u>Final budget</u> is the original budget, adjusted for all reserves, carry-over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative or similar authority changes applicable to the budget period.

<u>Multi-year budget</u> is an approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.

<u>Original budget</u> is the initial approved budget for the budget period.

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

Approved Budgets

8. An approved budget as defined by this Standard reflects the anticipated revenues or receipts expected to arise in the annual or multi-year budget period, based on current plans and the anticipated economic conditions during that budget period, and expenses or expenditures approved by a legislative body, being the legislature or other relevant authority. An approved budget is not a forward estimate, or a projection based on assumptions about future events and possible management actions that are not necessarily expected to

take place. Similarly, an approved budget differs from prospective financial information, which may be in the form of a forecast, a projection, or a combination of both; for example, a one-year forecast plus a five-year projection.

9. In some jurisdictions, budgets may be signed into law as part of the approval process. In other jurisdictions, approval may be provided without the budget becoming law. Whatever the approval process, the critical feature of approved budgets is that the authority to withdraw funds from the government treasury or similar body for agreed and identified purposes is provided by a higher legislative body or other appropriate authority. The approved budget establishes the expenditure authority for the specified items. The expenditure authority is generally considered the legal limit within which an entity must operate. In some jurisdictions, the approved budget for which the entity will be held accountable may be the original budget, and in others it may be the final budget.

10. If a budget is not approved prior to the beginning of the budget period, the original budget is the budget that was first approved for application in the budget year.

Original and Final Budget

11. The original budget may include residual appropriated amounts automatically carried over from prior years by law. For example, governmental budgetary processes in some jurisdictions include a legal provision that requires the automatic rolling forward of appropriations to cover prior year commitments. Commitments encompass possible future liabilities based on a current contractual agreement. In some jurisdictions, they may be referred to as obligations or encumbrances, and include outstanding purchase orders and contracts where goods or services have not yet been received.

12. Supplemental appropriations may be necessary where the original budget did not adequately envisage expenditure requirements arising from, for example, war or natural disasters. In addition, there may be a shortfall in budgeted revenues during the period, and internal transfers between budget heads or line items may be necessary to accommodate changes in funding priorities during the fiscal period. Consequently, the funds allotted to an entity or activity may need to be cut back from the amount originally appropriated for the period in order to maintain fiscal discipline. The final budget includes all such authorized changes or amendments.

Actual Amounts

13. This Standard uses the term actual or actual amount to describe the amounts that result from execution of the budget. In some jurisdictions, budget out-turn, budget execution, or similar terms may be used with the same meaning as actual or actual amount.

Presentation of a Comparison of Budget and Actual Amounts

14. **Subject to the requirements of paragraph 21, an entity shall present a comparison of the budget amounts for which it is held publicly accountable and actual amounts, either as a separate additional financial statement or as additional budget columns in the financial statements currently presented in accordance with IPSASs. The comparison of budget and actual amounts shall present separately for each level of legislative oversight:**

    (a) **The original and final budget amounts;**

    (b) **The actual amounts on a comparable basis; and**

    (c) **By way of note disclosure, an explanation of material differences between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements, and a cross reference to those documents is made in the notes.**

15. Presentation in the financial statements of the original and final budget amounts and actual amounts on a comparable basis with the budget that is made publicly available will complete the accountability cycle by enabling users of the financial statements to identify whether resources were obtained and used in accordance with the approved budget. Differences between the actual amounts and the budget amounts, whether original or final budget (often referred to as the variance in accounting), may also be presented in the financial statements for completeness.

16. An explanation of the material differences between actual amounts and the budget amounts will assist users in understanding the reasons for material departures from the approved budget for which the entity is held publicly accountable.

17. An entity may be required, or may elect, to make publicly available its original budget, its final budget, or both its original and final budget. In circumstances where both the original and final budget are required to be made publicly available, the legislation, regulation, or other authority will often provide guidance on whether explanation of material differences between the actual and the original budget amounts, or actual and the final budget amounts, is required in accordance with paragraph 14(c). In the absence of any such guidance, material differences may be determined by reference to, for example, (a) differences between actual and original budget to focus on performance against original budget, or (b) differences between actual and final budget to focus on compliance with the final budget.

18. In many cases, the final budget and the actual amount will be the same. This is because budget execution is monitored over the reporting period, and the

original budget progressively revised to reflect changing conditions, changing circumstances, and experiences during the reporting period. Paragraph 29 of this Standard requires the disclosure of an explanation of the reasons for changes between the original and final budget. Those disclosures, together with the disclosures required by paragraph 14 above, will ensure that entities that make publicly available their approved budget(s) are held publicly accountable for their performance against, and compliance with, the relevant approved budget.

19. Management discussion and analysis, operations review, or other public reports that provide commentary on the performance and achievements of the entity during the reporting period, including explanations of any material differences from budget amounts, are often issued in conjunction with the financial statements. In accordance with paragraph 14(c) of this Standard, explanation of material differences between actual and budget amounts will be included in notes to the financial statements, unless (a) included in other public reports or documents issued in conjunction with the financial statements, and (b) the notes to the financial statements identify the reports or documents in which the explanation can be found.

20. Where approved budgets are only made publicly available for some of the entities or activities included in the financial statements, the requirements of paragraph 14 will apply to only the entities or activities reflected in the approved budget. This means that where, for example, a budget is prepared only for the general government sector of a whole-of-government reporting entity, the disclosures required by paragraph 14 will be made only in respect of the general government sector of the government.

Presentation and Disclosure

21. **An entity shall present a comparison of budget and actual amounts as additional budget columns in the primary financial statements only where the financial statements and the budget are prepared on a comparable basis.**

22. Comparisons of budget and actual amounts may be presented in a separate financial statement, (Statement of Comparison of Budget and Actual Amounts or a similarly titled statement) included in the complete set of financial statements as specified in IPSAS 1. Alternatively, where the financial statements and the budget are prepared on a comparable basis – that is, on the same basis of accounting for the same entity and reporting period, and adopt the same classification structure – additional columns may be added to the existing primary financial statements presented in accordance with IPSASs. These additional columns will identify original and final budget amounts and, if the entity so chooses, differences between the budget and actual amounts.

23. When the budget and financial statements are not prepared on a comparable basis, a separate Statement of Comparison of Budget and Actual Amounts is presented. In these cases, to ensure that readers do not misinterpret financial information that is prepared on different bases, the financial statements could usefully clarify that the budget and the accounting bases differ, and that the Statement of Comparison of Budget and Actual Amounts is prepared on the budget basis.

24. In those jurisdictions where budgets are prepared on the accrual basis and encompass the full set of financial statements, additional budget columns can be added to all the primary financial statements required by IPSASs. In some jurisdictions, budgets prepared on the accrual basis may be presented in the form of only certain of the primary financial statements that comprise the full set of financial statements as specified by IPSASs – for example, the budget may be presented as a statement of financial performance or a cash flow statement, with additional information provided in supporting schedules. In these cases, the additional budget columns can be included in the primary financial statements that are also adopted for presentation of the budget.

Level of Aggregation

25. Budget documents may provide great detail about particular activities, programs, or entities. These details are often aggregated into broad classes under common budget heads, budget classifications, or budget headings for presentation to, and approval by, the legislature or other authoritative body. The disclosure of budget and actual information consistent with those broad classes and budget heads or headings will ensure that comparisons are made at the level of legislative or other authoritative body oversight identified in the budget documents.

26. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, requires financial statements to provide information that meets a number of qualitative characteristics, including that the information 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, that is, free from bias;

      (iv) Are prudent; and

      (v) Are complete in all material respects.

27. In some cases, the detailed financial information included in approved budgets may need to be aggregated for presentation in financial statements in accordance with the requirements of this Standard. Such aggregation may be necessary to avoid information overload and to reflect relevant levels of legislative or other authoritative body oversight. Determining the level of aggregation will involve professional judgment. That judgment will be applied in the context of the objective of this Standard and the qualitative characteristics of financial reporting as outlined in paragraph 26 above and Appendix A of IPSAS 1, which summarizes the qualitative characteristics of financial reporting.

28. Additional budget information, including information about service achievements, may be presented in documents other than financial statements. A cross reference from financial statements to such documents is encouraged, particularly to link budget and actual data to nonfinancial budget data and service achievements.

Changes from Original to Final Budget

29. **An entity shall present an explanation of whether changes between the original and final budget are a consequence of reallocations within the budget, or of other factors:**

    (a) **By way of note disclosure in the financial statements; or**

    (b) **In a report issued before, at the same time as, or in conjunction with, the financial statements, and shall include a cross reference to the report in the notes to the financial statements.**

30. The final budget includes all changes approved by legislative actions or other designated authority to revise the original budget. Consistent with the requirements of this Standard, a public sector entity will include in the notes to the financial statements or in a separate report issued before, in conjunction with, or at the same time as the financial statements, an explanation of changes between the original and final budget. That explanation will include whether, for example, changes arise as a consequence of reallocations within the original budget parameters or as a consequence of other factors, such as changes in the overall budget parameters, including changes in government policy. Such disclosures are often made in a management discussion and analysis or similar report on operations issued in conjunction with, but not as part of, the financial statements. Such disclosures may also be included in budget out-turn reports issued by governments to report on budget execution. Where disclosures are made in separate reports rather than in the financial statements, the notes to the financial statements will include a cross reference to the report.

Comparable Basis

31. **All comparisons of budget and actual amounts shall be presented on a comparable basis to the budget.**

32. The comparison of budget and actual amounts will be presented on the same accounting basis (accrual, cash, or other basis), same classification basis, and for the same entities and period as for the approved budget. This will ensure that the disclosure of information about compliance with the budget in the financial statements is on the same basis as the budget itself. In some cases, this may mean presenting a budget and actual comparison on a different basis of accounting, for a different group of activities, and with a different presentation or classification format than that adopted for the financial statements.

33. Financial statements consolidate entities and activities controlled by the entity. As noted in paragraph 5, separate budgets may be approved and made publicly available for individual entities or particular activities that make up the consolidated financial statements. Where this occurs, the separate budgets may be recompiled for presentation in the financial statements in accordance with the requirements of this Standard. Where such recompilation occurs, it will not involve changes or revisions to approved budgets. This is because this Standard requires a comparison of actual amounts with the approved budget amounts.

34. Entities may adopt different bases of accounting for the preparation of their financial statements and for their approved budgets. For example, a government may adopt the accrual basis for its financial statements and the cash basis for its budget. In addition, budgets may focus on, or include information about, commitments to expend funds in the future and changes in those commitments, while the financial statements will report assets, liabilities, net assets/equity, revenues, expenses, other changes in net assets/equity, and cash flows. However, the budget entity and financial reporting entity will often be the same. Similarly, the period for which the budget is prepared and the classification basis adopted for the budget will often be reflected in financial statements. This will ensure that the accounting system records and reports financial information in a manner that facilitates the comparison of budget and actual data for management and for accountability purposes, for example, for monitoring progress of execution of the budget during the budget period and for reporting to the government, the public, and other users on a relevant and timely basis.

35. In some jurisdictions, budgets may be prepared on a cash or accrual basis consistent with a statistical reporting system that encompasses entities and activities different from those included in the financial statements. For example, budgets prepared to comply with a statistical reporting system may focus on the general government sector, and encompass only entities fulfilling

the primary or nonmarket functions of government as their major activity, while financial statements report on all activities controlled by a government, including the business activities of the government. IPSAS 22, *Disclosure of Financial Information about the General Government Sector,* specifies requirements for note disclosure of financial information about the general government sector of a whole-of-government entity that adopts the accrual basis of accounting and elects to make such disclosures. In many cases, disclosures made in accordance with IPSAS 22 will encompass the same entities, activities, and classification bases as adopted in budgets prepared consistent with the general government sector as defined in statistical reporting models. In these cases, disclosures made in accordance with IPSAS 22 will also facilitate the disclosures required by this Standard.

36. In statistical reporting models, the general government sector may comprise national, state/provincial, and local government levels. In some jurisdictions, the national government may (a) control state/provincial and local governments, (b) consolidate those governments in its financial statements and (c) develop, and require to be made publicly available, an approved budget that encompasses all three levels of government. In these cases, the requirements of this Standard will apply to the financial statements of those national governmental entities. However, where a national government does not control state/provincial or local governments, its financial statements will not consolidate state/provincial or local governments. Rather, separate financial statements are prepared for each level of government. The requirements of this Standard will only apply to the financial statements of governmental entities when approved budgets for the entities and activities they control, or subsections thereof, are made publicly available.

Multi-year Budgets

37. Some governments and other entities approve and make publicly available multi-year budgets, rather than separate annual budgets. Conventionally, multi-year budgets comprise a series of annual budgets or annual budget targets. The approved budget for each component annual period reflects the application of the budgetary policies associated with the multi-year budget for that component period. In some cases, the multi-year budget provides for a roll forward of unused appropriations in any single year.

38. Governments and other entities with multi-year budgets may take different approaches to determining their original and final budget, depending on how their budget is passed. For example, a government may pass a biennial budget that contains two approved annual budgets, in which case an original and final approved budget for each annual period will be identifiable. If unused appropriations from the first year of the biennial budget are legally authorized to be spent in the second year, the original budget for the second-year period will be increased for these carry over amounts. In the rare cases in which a

government passes a biennial or other multi-period budget that does not specifically separate budget amounts into each annual period, judgment may be necessary in identifying which amounts are attributable to each annual period in determining annual budgets for the purposes of this Standard. For example, the original and final approved budget for the first year of a biennial period will encompass any approved capital acquisitions for the biennial period that occurred during the first year, together with the amount of the recurring revenue and expenditure items attributable to that year. The unexpended amounts from the first annual period would then be included in the original budget for the second annual period, and that budget together with any amendments thereto would form the final budget for the second year. Where multi-period budgets are adopted, entities are encouraged to provide additional note disclosure about the relationship between budget and actual amounts during the budget period.

Note Disclosures of Budgetary Basis, Period and Scope

39. **An entity shall explain in notes to the financial statements the budgetary basis and classification basis adopted in the approved budget.**

40. There may be differences between the accounting basis (cash, accrual, or some modification thereof) used in preparation and presentation of the budget and the accounting basis used in the financial statements. These differences may occur when the accounting system and the budget system compile information from different perspectives – the budget may focus on cash flows, or cash flows plus certain commitments, while the financial statements report cash flows and accrual information.

41. Formats and classification schemes adopted for presentation of the approved budget may also differ from the formats adopted for the financial statements. An approved budget may classify items on the same basis as is adopted in the financial statements, for example, by economic nature (compensation of employees, use of goods or services, etc.), or function (health, education, etc.). Alternatively, the budget may classify items by specific programs (for example, poverty reduction or control of contagious diseases) or program components linked to performance outcome objectives (for example, students graduating from tertiary education programs or surgical operations performed by hospital emergency services), which differ from classifications adopted in the financial statements. Further, a recurrent budget for ongoing operations (for example, education or health) may be approved separately from a capital budget for capital outlays (for example, infrastructure or buildings).

42. IPSAS 1 requires entities to present, in notes to the financial statements, information about the basis of preparation of the financial statements and the significant accounting policies adopted. Disclosure of the budgetary basis and classification basis adopted for the preparation and presentation of approved

budgets will assist users to better understand the relationship between the budget and accounting information disclosed in the financial statements.

43. **An entity shall disclose in notes to the financial statements the period of the approved budget.**

44. Financial statements are presented at least annually. Entities may approve budgets for an annual period or for multi-year periods. Disclosure of the period covered by the approved budget, where that period differs from the reporting period adopted for the financial statements, will assist the users of those financial statements to better understand the relationship of the budget data and budget comparison to the financial statements. Disclosure of the period covered by the approved budget, where that period is the same as the period covered by the financial statements, will also serve a useful confirmation role, particularly in jurisdictions where interim budgets and financial statements and reports are also prepared.

45. **An entity shall identify in notes to the financial statements the entities included in the approved budget.**

46. IPSASs require entities to prepare and present financial statements that consolidate all resources controlled by the entity. At the whole-of-government level, financial statements prepared in accordance with IPSASs will encompass budget-dependent entities and GBEs controlled by the government. However, as noted in paragraph 35, approved budgets prepared in accordance with statistical reporting models may not encompass operations of the government that are undertaken on a commercial or market basis. Consistent with the requirements of paragraph 31, budget and actual amounts will be presented on a comparable basis. Disclosure of the entities encompassed by the budget will enable users to identify the extent to which the entity's activities are subject to an approved budget, and how the budget entity differs from the entity reflected in the financial statements.

Reconciliation of Actual Amounts on a Comparable Basis and Actual Amounts in the Financial Statements

47. **The actual amounts presented on a comparable basis to the budget in accordance with paragraph 31 shall, where the financial statements and the budget are not prepared on a comparable basis, be reconciled to the following actual amounts presented in the financial statements, identifying separately any basis, timing, and entity differences:**

    (a) **If the accrual basis is adopted for the budget, total revenues, total expenses, and net cash flows from operating activities, investing activities, and financing activities; or**

(b) **If a basis other than the accrual basis is adopted for the budget, net cash flows from operating activities, investing activities, and financing activities.**

The reconciliation shall be disclosed on the face of the statement of comparison of budget and actual amounts, or in the notes to the financial statements.

48. Differences between the actual amounts identified consistent with the comparable basis, and the actual amounts recognized in the financial statements, can usefully be classified into the following:

(a) Basis differences, which occur when the approved budget is prepared on a basis other than the accounting basis. For example, where the budget is prepared on the cash basis or modified cash basis and the financial statements are prepared on the accrual basis;

(b) Timing differences, which occur when the budget period differs from the reporting period reflected in the financial statements; and

(c) Entity differences, which occur when the budget omits programs or entities that are part of the entity for which the financial statements are prepared.

There may also be differences in formats and classification schemes adopted for presentation of financial statements and the budget.

49. The reconciliation required by paragraph 47 of this Standard will enable the entity to better discharge its accountability obligations, by identifying major sources of difference between the actual amounts on a budget basis and the amounts recognized in the financial statements. This Standard does not preclude reconciliation of each major total and subtotal, or each class of items, presented in a comparison of budget and actual amounts with the equivalent amounts in the financial statements.

50. For some entities adopting the same basis of accounting for preparation of both the budget documents and the financial statements, only the identification of differences between actual amounts in the budget and the equivalent amounts in the financial statements will be required. This will occur where the budget (a) is prepared for the same period, (b) encompasses the same entities, and (c) adopts the same presentation format as the financial statements. In these cases, a reconciliation is not required. For other entities adopting the same basis of accounting for the budget and the financial statements, there may be a difference in presentation format, reporting entity, or reporting period; for example, the approved budget may adopt a different classification or presentation format to the financial statements, may include only noncommercial activities of the entity, or maybe a multi-year budget. A reconciliation would be necessary where there are presentation, timing, or

entity differences between the budget and the financial statements prepared on the same accounting basis.

51. For those entities using the cash basis (or a modified cash or modified accrual basis) of accounting for the presentation of the approved budget and the accrual basis for their financial statements, the major totals presented in the statement of budget and actual comparison will be reconciled to net cash flows from operating activities, net cash flows from investing activities, and net cash flows from financing activities as presented in the cash flow statement prepared in accordance with IPSAS 2, *Cash Flow Statements*.

52. **The disclosure of comparative information in respect of the previous period in accordance with the requirements of this Standard is not required.**

53. This Standard requires a comparison of budget and actual amounts to be included in the financial statements of entities that make publicly available their approved budget(s). It does not require the disclosure of a comparison of actuals of the previous period with the budget of that previous period, nor does it require that the related explanations of differences between the actuals and budget of that previous period be disclosed in the financial statements of the current period.

Effective Date

54. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2009. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2009, it shall disclose that fact.**

54A. **Paragraph 55 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.**

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

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 24.

Scope of the Standard

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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. In many jurisdictions, legislation or other authority requires public sector entities, whether the government or a particular government entity, to make public the approved budget(s) for which they are held accountable. Such disclosure is required in the interest of transparency of government. In some cases, a government or government entity not subject to such legislation or other authority may voluntarily elect to make its approved budget publicly available. This Standard applies to governments and government entities that make publicly available the approved budget(s) for which they are held accountable.

BC3. The approved budget reflects the financial characteristics of the government's or other entity's plans for the forthcoming period and, in respect of activities funded from the government budget, represent the authority to expend funds. Reporting the results of budget execution against those financial plans will enhance the transparency of financial statements, and is an important element in the discharge of accountability of entities which are required to, or elect to, make their budget(s) publicly available. The inclusion of a comparison of budget and actual amounts in financial statements will provide financial information to assist users to assess whether resources were raised as anticipated and used in accordance with the budget(s) approved by the legislature or other authoritative body. This Standard uses the term actual or actual amount to describe the amounts that result from execution of the budget. In other jurisdictions, budget out-turn, budget execution, or similar terms may be used with the same meaning as actual or actual amount.

BC4. Many governments and government entities that make publicly available their approved budget(s) already report actual against budgeted amounts in their financial statements. They also include an explanation of material differences between actual and budget (a) in notes to their financial statements, or (b) in management discussion and analysis or similar reports, or (c) in budget out-turn or similar reports issued in conjunction with their financial statements. For these governments and government entities, comparisons of budget and actual amounts are generally made at the levels of oversight approved by the legislature or similar authority, and explanations of material differences are made where budgetary authority is exceeded. The IPSASB is of the view that this practice is appropriate, and has issued this Standard to reinforce the practice, and to require that it be adopted by all entities that make publicly available their approved budgets.

BC5. This Standard does not require entities to make publicly available their approved budgets, or specify presentation requirements for approved budgets that are made publicly available. That is beyond the scope of this Standard. However, the IPSASB has indicated that in the future it will consider whether an IPSAS should be developed to deal with these matters.

Need for an International Public Sector Accounting Standard

BC6. IPSAS 1 explains that the purpose of financial statements encompasses the disclosure of information to discharge the entity's obligation (a) to be accountable for such matters as its financial position, performance, and cash flows, and (b) to provide information useful to assess its performance in terms of its service costs, efficiency, and accomplishments. It also notes that financial reporting may provide users with information about an entity's compliance with, for example, the legally adopted budget.

BC7. Prior to issue of this Standard, IPSAS 1 encouraged, but did not require, financial statements to include a comparison of budget and actual amounts where the financial statements and the budget are on the same basis. However, in some cases, an entity may make public an approved budget prepared and presented on a different basis to the financial statements, and elect to include in financial statements a comparison of actual and budget. IPSAS 1 did not provide guidance on the details to be disclosed or the manner of presentation in such circumstances. The IPSASB is of the view that IPSASs should deal with such circumstances.

BC8. This Standard applies where an entity is required to make publicly available its approved budget(s), or elects to do so. The IPSASB is of the view that, in such cases, the intent and effect of the legislature or other authority, or the voluntary action of the entity itself, is clear – the entity is held publicly accountable for its performance against and compliance with the budget. The IPSASB is also of the view that disclosure of information about budget and actual amounts is a necessary element for the discharge of accountability for such entities, and requirements to ensure appropriate disclosure in financial statements should be included in an IPSAS.

BC9. The application of the requirements of this Standard for the disclosure of a comparison of actual and budget amounts, where the financial statements and the budget are prepared on the same basis, will further enhance the discharge of the entity's accountability for its performance. The application of the requirements of this Standard, where the budget and the financial statements are prepared on different bases, will reinforce the role of financial statements in discharging the entity's obligation to be accountable for its compliance with approved budgets.

BC10. The IPSASB considered whether it should require or encourage all public sector entities other than GBEs to make publicly available their approved budgets and to comply with the requirements of this Standard. The IPSASB noted that the purpose of this Standard was not to specify whether approved budgets should be made publicly available, and agreed that it should not impose such requirements on entities or add to existing encouragements until it had further considered its role in respect of developing requirements for budget reporting. The IPSASB also noted that public sector entities that do not make publicly available their approved budgets are not prohibited from applying the requirements of this Standard if they choose to do so.

Comparisons with Approved Budget

BC11. This Standard requires disclosure of the original and final budget amounts and actual amounts on a comparable basis with the budget amounts. This reinforces the compliance component of accountability identified in IPSAS 1. Users of the financial statements will be able to identify and determine the differences between amounts in the original and/or final approved budget and their equivalent actual amounts (often referred to as “variances” in accounting) for each level of legislative oversight disclosed.

BC12. This Standard requires an explanation of material differences (whether positive or negative) between actual and budget amounts to be made by way of note disclosure in the financial statements, unless such explanation is included in other publicly available documents issued in conjunction with the financial statements. The IPSASB is of the view that disclosure of this information will enhance the transparency of financial statements, and strengthen the accountability of entities that make their budgets publicly available. The explanation of such differences may be included in a management discussion and analysis, operations review, budget out-turn, or similar report issued in conjunction with the financial statements. The IPSASB is of the view that where explanation is included in such reports, and notes to the financial statements direct readers to those reports, it is not necessary to repeat that explanation in the financial statements.

Disclosure of Original and Final Budget

BC13. Budgets are prepared in advance of the reporting period, and the occurrence of natural disasters and changes in political or economic conditions may dictate a need for revisions to the initially approved budget during the budget period. In some jurisdictions, the authority for such revisions (within specified limits) is delegated to the Minister of Finance or similar office-holder. In other jurisdictions, the revisions must be approved by the legislature. Where those revisions are authorized by the appropriate authority, they comprise the final budget for the reporting period. The IPSASB is of the view that disclosure of the original and final budget is necessary to ensure that readers of the financial statements are aware of the nature and extent of changes to the original budget that have been approved during the course of the reporting period.

BC14. Revisions to the original budget may occur as a result of policy shifts, including changes in government priorities during the reporting period, or of unanticipated economic conditions. The IPSASB is of the view that disclosure of an explanation of the reasons for changes between the original and final budget during the reporting period, including whether changes between the original and final budget are a consequence of reallocations within the budget or of other factors, is necessary for the discharge of accountability, and will provide useful input for analysis of the financial effects of changing economic conditions and of policy shifts. The explanation may be included in the notes to the financial statements or in a report issued before, at the same time as, or in conjunction with, the financial statements. As noted above in respect of explanations of budget variances, the IPSASB is of the view that where an explanation is included in such reports, and notes to the financial statements direct readers to those reports, it is not necessary to repeat that explanation in the financial statements.

Adoption of the Budget Basis and Reconciliation of Budget and Accounting Bases

BC15. Entities may adopt different accounting bases for the preparation of their financial statements and for their approved budgets. In particular, some entities that adopt the accrual basis of accounting for preparation of their financial statements prepare their budgets on the cash basis. Differences between the budgetary basis and the financial statements may also arise as a consequence of timing, entity, or classification differences.

BC16. This Standard requires that the comparisons of budget and actual amounts be presented on the same basis (format, terminology, budgetary basis, and classification) and for the same entities and period as for the approved budget. This is necessary to enable the financial statements to demonstrate the extent to which actual amounts were used in accordance with legally authorized budgets. It will ensure that disclosures are made on a comparable basis, and that the financial statements demonstrate compliance with the approved budget. Consequently, amounts reflected in the financial statements will need to be recast to be comparable to the approved budget where there are basis, timing, or entity differences.

BC17. To better enable users to identify the relationship between the budget and the financial statements, this Standard requires that when the financial statements and the budget are not prepared on a comparable basis, actual amounts on the budget basis are to be reconciled to specified equivalent amounts presented in the financial statements, identifying separately any basis, timing, and entity differences. If the budget and the financial statements are prepared on the same basis, the reconciliation of differences would not be necessary.

Presentation of Budget and Actual Information

BC18. This Standard allows the budget and actual information to be presented in a separate statement or, only when the budget and the financial statements are prepared on a comparable basis, as an additional budget column in existing financial statements. Flexibility in the method of presentation allows entities to present the comparison in a manner that best serves user needs, while at the same time retaining the prominence that comes from inclusion in the financial statements. The prohibition on adopting the additional column approach for presentation when the financial statements and budget are prepared on a different basis of accounting is necessary to ensure that the comparison of budget and actual amounts are presented on a comparable basis.

Initial Application

BC19. This Standard was issued by the IPSASB in December 2006. Its application is not required until periods beginning on or after January 1, 2009. The deferred application is intended to provide sufficient time for entities to develop and, as appropriate, align their budget and financial reporting procedures, time periods and coverage. Earlier adoption of this Standard is encouraged.

BC20. The IPSASB considered whether to also provide relief from application of this Standard for two years from initial adoption of IPSASs, but considered that such relief was not necessary. This was because entities would assess, and factor into their timing for initial adoption of all IPSASs, the requirements of this Standard.

Relief from the Requirement to Disclose Comparative Amounts

BC21. This Standard does not require that the financial statements of the current period include the disclosure of a comparison of actuals of a previous period with the budget of that previous period, nor does it require that the related explanations of differences between the actuals and budget of that previous period be disclosed in the financial statements of the current period.

BC22. The focus of this Standard is on supporting the discharge of the entity's obligation to be accountable for its compliance with the approved budget for the current reporting period. Many explanatory disclosures required by this Standard may be located in other documents issued in conjunction with, but not as part of, the financial statements. The IPSASB is concerned that the requirement for disclosure of comparative information would result in information overload and an over-complex network of reporting requirements, and would not be in the interests of users of the financial statements.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 24.

Statement of Comparison of Budget and Actual Amounts

For Government XX for the Year Ended December 31, 20XX
Budget on Cash Basis
(Classification of Payments by Functions)

Note: The budget and the accounting basis is different. This Statement of Comparison of Budget and Actual Amounts is prepared on the budget basis.

	Budgeted Amounts		**Actual Amounts on Comparable Basis**	*Difference: Final Budget and Actual* [*]
(in currency units)	**Original**	**Final**		
RECEIPTS				
Taxation	X	X	X	X
Aid Agreements				
International agencies	X	X	X	X
Other Grants and Aid	X	X	X	X
Proceeds: Borrowing	X	X	X	X
Proceeds: Disposal of plant and equipment	X	X	X	X
Trading Activities	X	X	X	X
Other receipts	X	X	X	X
Total receipts	**X**	**X**	**X**	**X**
PAYMENTS				
Health	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)
Public order/safety	(X)	(X)	(X)	(X)
Social protection	(X)	(X)	(X)	(X)
Defense	(X)	(X)	(X)	(X)
Housing and community amenities	(X)	(X)	(X)	(X)
Recreational, cultural and religion	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)
Total payments	**(X)**	**(X)**	**(X)**	**(X)**
NET RECEIPTS/(PAYMENTS)	**X**	**X**	**X**	**X**

[*] The "Difference…" column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

Additional Column Approach

For Government YY for the Year Ended December 31, 20XX
Both Annual Budget And Financial Statements Adopt Accrual Basis
(Illustrated only for Statement of Financial Performance. Similar presentation would be adopted for other financial statements.)

Actual 20XX-1	(in currency units)	**Actual 20XX**	**Final Budget 20XX**	**Original Budget 20XX**	**Difference: Original Budget and Actual*
	Revenue				
X	Taxes	X	X	X	X
X	Fees, fines, penalties, and licenses	X	X	X	X
X	Revenue from exchange transactions	X	X	X	X
X	Transfers from other governments	X	X	X	X
X	Other revenue	X	X	X	X
X	**Total revenue**	**X**	**X**	**X**	**X**
	Expenses				
(X)	Wages, salaries, employee benefits	(X)	(X)	(X)	(X)
(X)	Grants and other transfer payments	(X)	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)	(X)
(X)	Depreciation/amortization expense	(X)	(X)	(X)	(X)
(X)	Other expenses	(X)	(X)	(X)	(X)
(X)	Finance costs	(X)	(X)	(X)	(X)
(X)	**Total expenses**	**(X)**	**(X)**	**(X)**	**(X)**
X	Share of surplus of associates	X	X	X	X
X	**Surplus/(deficit) for the period**	**X**	**X**	**X**	**X**
	Attributable to:				
X	Owners of the controlling entity	X	X	X	X
X	Non-controlling interest	X	X	X	X
X		**X**	**X**	**X**	**X**

* The "Difference…" column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

Extract of Note Disclosures—for Government X

(Government X presents its approved budget on a cash basis and the financial statements on the accrual basis.)

1. The budget is approved on a cash basis by functional classification. The approved budget covers the fiscal period from January 1, 20XX to December 31, 20XX, and includes all entities within the general government sector. The general government sector includes all entities identified as government departments in note xx (prepared in accordance with IPSAS 35, *Consolidated Financial Statements*.)

2. The original budget was approved by legislative action on (date), and a supplemental appropriation of XXX for disaster relief support was approved by legislative action on (date) due to the earthquake in the Northern Region on (date). The original budget objectives and policies and subsequent revisions are explained more fully in the Operational Review and Budget Outcomes reports issued in conjunction with the financial statements.

3. The excess of actual expenditure over the final budget of 15% (25% over original budget) for the Health function was due to expenditures above the level approved by legislative action in response to the earthquake. There were no other material differences between the final approved budget and the actual amounts.

4. The budget and the accounting bases differ. The financial statements for the whole-of-government are prepared on the accrual basis, using a classification based on the nature of expenses in the statement of financial performance. The financial statements are consolidated statements that include all controlled entities, including government business enterprises for the fiscal period from January 1, 20XX to December 31, 20XX. The financial statements differ from the budget which is approved on the cash basis and which deals only with the general government sector which excludes government business enterprises and certain other non-market government entities and activities.

5. The amounts in the financial statements were recast from the accrual basis to the cash basis, and reclassified by functional classification to be on the same basis as the final approved budget. In addition, adjustments to amounts in the financial statements for timing differences associated with the continuing appropriation and differences in the entities covered (GBEs) were made to express the actual amounts on a comparable basis to the final approved budget. The amount of these adjustments are identified in the following table.

6. A reconciliation between the actual amounts on a comparable basis as presented in the Statement of Comparison of Budget and Actual Amounts and the actual amounts in the Statement of Cash Flows for the Year Ended December 31, 20XX is presented below. The financial statements and budget

documents are prepared for the same period. There is an entity difference: the budget is prepared for the general government sector, and the financial statements consolidate all entities controlled by the government. There is also a basis difference: the budget is prepared on a cash basis and the financial statements on the accrual basis.

	Operating	**Financing**	**Investing**	**Total**
Actual Amount on Comparable Basis as Presented in the Budget and Actual Comparative Statement	**X**	**X**	**X**	**X**
Basis Differences	**X**	**X**	**X**	**X**
Timing Differences	-	-	-	-
Entity Differences	**X**	**X**	**X**	**X**
Actual Amount in the Statement of Cash Flows	**X**	**X**	**X**	**X**

(This reconciliation could be included on the face of the Statement of Comparison of Budget and Actual Amounts or as a note disclosure.)

Encouraged Note Disclosure: Biennial Budget on Cash Basis—For Government B for the Year Ended December 31, 20XX

(in currency units)	**Original Biennial Budget Year**	**Target Budget for 1st Year**	**Revised Budget in 1st Year**	**1st Year Actual on Comparable Basis**	**Balance Available for 2nd Year**	**Target Budget for 2nd Year**	**Revised Budget in 2nd Year**	**2nd Year Actual on Comparable Basis**	*Difference: Budget and Actual over Budget Period*
RECEIPTS									
Taxation	X	X	X	X	X	X	X	X	X
Aid Agreements	X	X	X	X	X	X	X	X	X
Proceeds: Borrowing	X	X	X	X	X	X	X	X	X
Proceeds: Disposal of plant and equipment	X	X	X	X	X	X	X	X	X
Trading Activities									
Other receipts	X	X	X	X	X	X	X	X	X
Total receipts	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
PAYMENTS									
Health	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Public order and safety	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Social protection	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)

* This column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

(in currency units)	**Original Biennial Budget Year**	**Target Budget for 1st Year**	**Revised Budget in 1st Year**	**1st Year Actual on Comparable Basis**	**Balance Available for 2nd Year**	**Target Budget for 2nd Year**	**Revised Budget in 2nd Year**	**2nd Year Actual on Comparable Basis**	**Difference: Budget and Actual over Budget Period*
Defense	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Housing, community amenities	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Recreational, cultural, religion	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Total payments	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**
NET RECEIPTS/ (PAYMENTS)	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**

IPSAS 25—EMPLOYEE BENEFITS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 19 (2004), *Employee Benefits*, published by the International Accounting Standards Board (IASB). Extracts from IAS 19 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 25—EMPLOYEE BENEFITS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 25, *Employee Benefits* was issued in February 2008.

Since then, IPSAS 25 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 25

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
10	Amended	Improvements to IPSASs January 2010 Improvements to IPSASs November 2010
11	Amended	Improvements to IPSASs January 2010
37	Amended	Improvements to IPSASs January 2010
113	Amended	Improvements to IPSASs January 2010
114	Amended	Improvements to IPSASs January 2010
131	Amended	Improvements to IPSASs January 2010
131A	New	Improvements to IPSASs January 2010
166	Deleted	IPSAS 33 January 2015
167	Deleted	IPSAS 33 January 2015

Paragraph Affected	How Affected	Affected By
168	Deleted	IPSAS 33 January 2015
169	Deleted	IPSAS 33 January 2015
170	Deleted	IPSAS 33 January 2015
171	Deleted	IPSAS 33 January 2015
172	Deleted	IPSAS 33 January 2015
173	Deleted	IPSAS 33 January 2015
174	Deleted	IPSAS 33 January 2015
175	Deleted	IPSAS 33 January 2015
176	Deleted	IPSAS 33 January 2015
177A	New	Improvements to IPSASs January 2010
177B	New	IPSAS 33 January 2015
178	Amended	IPSAS 33 January 2015

February 2008

IPSAS 25—EMPLOYEE BENEFITS

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Appendix A: Application Guidance

Basis for Conclusions

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Comparison with IAS 19

International Public Sector Accounting Standard 25, *Employee Benefits*, is set out in paragraphs 1–178. All the paragraphs have equal authority. IPSAS 25 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors,* provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an entity to recognize:

   (a) A liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

   (b) An expense when the entity consumes the economic benefits or service potential arising from service provided by an employee in exchange for employee benefits.

Scope

2. **This Standard shall be applied by an employer in accounting for all employee benefits, except share-based transactions (see the relevant international or national accounting standard dealing with share-based transactions).**

3. This Standard does not deal with reporting by employee retirement benefit plans (see the relevant international or national accounting standard dealing with employee retirement benefit plans). This Standard does not deal with benefits provided by composite social security programs that are not consideration in exchange for service rendered by employees or past employees of public sector entities.

4. The employee benefits to which this Standard applies include those provided:

   (a) Under formal plans or other formal agreements between an entity and individual employees, groups of employees, or their representatives;

   (b) Under legislative requirements, or through industry arrangements, whereby entities are required to contribute to national, state, industry, or other multi-employer plans, or where entities are required to contribute to the composite social security program; or

   (c) By those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

5. Employee benefits include:

   (a) Short-term employee benefits, such as wages, salaries, and social security contributions; paid annual leave and paid sick leave; profit-sharing and bonuses (if payable within twelve months of the end of the period); and non-monetary benefits (such as medical care, housing, cars, and free or subsidized goods or services) for current employees;

(b) Post-employment benefits such as pensions, other retirement benefits, post-employment life insurance, and post-employment medical care;

(c) Other long-term employee benefits, which may include long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses, and deferred compensation; and

(d) Termination benefits.

Because each category identified in (a)–(d) above has different characteristics, this Standard establishes separate requirements for each category.

6. Employee benefits include benefits provided to either employees or their dependants, and may be settled by payments (or the provision of goods or services) made either directly to the employees, to their spouses, children, or other dependants, or to others, such as insurance companies.

7. An employee may provide services to an entity on a full-time, part-time, permanent, casual, or temporary basis. For the purpose of this Standard, employees include key management personnel as defined in IPSAS 20, *Related Party Disclosures*.

8. **This Standard applies to all public sector entities other than Government Business Enterprises.**

9. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

Definitions

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

<u>Actuarial gains and losses</u> comprise:

(a) **Experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and**

(b) **The effects of changes in actuarial assumptions.**

<u>Assets held by a long-term employee benefit fund</u> are assets (other than non-transferable financial instruments issued by the reporting entity) that:

(a) **Are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and**

(b) **Are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:**

(i) **The remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or**

(ii) **The assets are returned to the reporting entity to reimburse it for employee benefits already paid.**

<u>Composite social security programs</u> are established by legislation, and

(a) **Operate as multi-employer plans to provide post-employment benefits; as well as to**

(b) **Provide benefits that are not consideration in exchange for service rendered by employees.**

<u>Current service cost</u> is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

<u>Defined benefit plans</u> are post-employment benefit plans other than defined contribution plans.

<u>Defined contribution plans</u> are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund), and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

<u>Employee benefits</u> are all forms of consideration given by an entity in exchange for service rendered by employees.

<u>Interest cost</u> is the increase during a period in the present value of a defined benefit obligation that arises because the benefits are one period closer to settlement.

<u>Multi-employer plans</u> are defined contribution plans (other than state plans and composite social security programs) or defined benefit plans (other than state plans) that:

(a) **Pool the assets contributed by various entities that are not under common control; and**

(b) **Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.**

Other long-term employee benefits are employee benefits (other than post-employment benefits and termination benefits) that are not due to be settled within twelve months after the end of the period in which the employees render the related service.

Past service cost is the change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when existing benefits are changed so that the present value of the defined benefit obligation decreases).

Plan assets comprise:

(a) **Assets held by a long-term employee benefit fund; and**

(b) **Qualifying insurance policies.**

Post-employment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.

Post-employment benefit plans are formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.

The present value of a defined benefit obligation is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

A qualifying insurance policy is an insurance policy[*] issued by an insurer that is not a related party (as defined in IPSAS 20) of the reporting entity, if the proceeds of the policy:

(a) **Can be used only to pay or fund employee benefits under a defined benefit plan; and**

(b) **Are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:**

[*] A qualifying insurance policy is not necessarily an insurance contract (see the relevant international or national standard dealing with insurance contracts).

(i) **The proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or**

(ii) **The proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.**

The return on plan assets is interest, dividends or similar distributions and other revenue derived from the plan assets, together with realized and unrealized gains or losses on the plan assets, less any costs of administering the plan (other than those included in the actuarial assumptions used to measure the defined benefit obligation) and less any tax payable by the plan itself.

Short-term employee benefits are employee benefits (other than termination benefits) that are due to be settled within twelve months after the end of the period in which the employees render the related service.

State plans are plans other than composite social security programs established by legislation that operate as if they are multi-employer plans for all entities in economic categories laid down in legislation.

Termination benefits are employee benefits payable as a result of either:

(a) **An entity's decision to terminate an employee's employment before the normal retirement date; or**

(b) **An employee's decision to accept voluntary redundancy in exchange for those benefits.**

Vested employee benefits are employee benefits that are not conditional on future employment.

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

Short-Term Employee Benefits

11. Short-term employee benefits include items such as:

(a) Wages, salaries, and social security contributions;

(b) Short-term compensated absences (such as paid annual leave and paid sick leave) where the compensation for the absences is due to be settled within twelve months after the end of the period in which the employees render the related employee service;

(c) Performance related bonuses and profit-sharing payable within twelve months after the end of the period in which the employees render the related service; and

(d) Non-monetary benefits (such as medical care, housing, cars, and free or subsidized goods or services) for current employees.

12. Accounting for short-term employee benefits is generally straightforward, because no actuarial assumptions are required to measure the obligation or the cost, and there is no possibility of any actuarial gain or loss. Moreover, short-term employee benefit obligations are measured on an undiscounted basis.

Recognition and Measurement

All Short-Term Employee Benefits

13. **When an employee has rendered service to an entity during an accounting period, the entity shall recognize the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service:**

(a) **As a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognize that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and**

(b) **As an expense, unless another Standard requires or permits the inclusion of the benefits in the cost of an asset (see, for example, IPSAS 12, *Inventories*, and IPSAS 17, *Property, Plant, and Equipment.***

Paragraphs 14, 17, and 20 explain how an entity shall apply this requirement to short-term employee benefits in the form of compensated absences and bonus and profit-sharing plans.

Short-Term Compensated Absences

14. **An entity shall recognize the expected cost of short-term employee benefits in the form of compensated absences under paragraph 13 as follows:**

(a) **In the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences; and**

(b) **In the case of non-accumulating compensated absences, when the absences occur.**

15. An entity may compensate employees for absence for various reasons, including vacation, sickness and short-term disability, maternity or paternity, jury service, and military service. Entitlement to compensated absences falls into two categories:

(a) Accumulating; and

(b) Non-accumulating.

16. Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating compensated absences may be either vesting (in other words, employees are entitled to a cash payment for unused entitlement on leaving the entity) or nonvesting (when employees are not entitled to a cash payment for unused entitlement on leaving). An obligation arises as employees render service that increases their entitlement to future compensated absences. The obligation exists, and is recognized, even if the compensated absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation.

17. **An entity shall measure the expected cost of accumulating compensated absences as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the reporting date.**

18. The method specified in paragraph 17 measures the obligation at the amount of the additional payments that are expected to arise solely from the fact that the benefit accumulates. In many cases, an entity may not need to make detailed computations to estimate that there is no material obligation for unused compensated absences. For example, a sick leave obligation is likely to be material only if there is a formal or informal understanding that unused paid sick leave may be taken as paid vacation.

19. Non-accumulating compensated absences do not carry forward; they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the entity. This is commonly the case for sick pay (to the extent that unused past entitlement does not increase future entitlement), maternity or paternity leave, and compensated absences for jury service or military service. An entity recognizes no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit.

Bonus Payments and Profit-Sharing Payments

20. **An entity shall recognize the expected cost of bonus payments and profit-sharing payments under paragraph 13 when, and only when:**

(a) **The entity has a present legal or constructive obligation to make such payments as a result of past events; and**

(b) **A reliable estimate of the obligation can be made.**

A present obligation exists when, and only when, the entity has no realistic alternative but to make the payments.

21. In the public sector, some entities have bonus plans that are related to service delivery objectives or aspects of financial performance. Under such plans, employees receive specified amounts, dependent on an assessment of their contribution to the achievement of the objectives of the entity or a segment of the entity. In some cases, such plans may be for groups of employees, such as when performance is evaluated for all or some employees in a particular segment, rather than on an individual basis. Because of the objectives of public sector entities, profit-sharing plans are far less common in the public sector than for profit-oriented entities. However, they are likely to be an aspect of employee remuneration in segments of public sector entities that operate on a commercial basis. Some public sector entities may not operate profit-sharing schemes, but may evaluate performance against financially based measures such as the generation of revenue streams and the achievement of budgetary targets. Some bonus plans may entail payments to all employees who rendered employment services in a reporting period, even though they may have left the entity before the reporting date. However, under other bonus plans, employees receive payments only if they remain with the entity for a specified period, for example, a requirement that employees render services for the whole of the reporting period. Such plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. The measurement of such constructive obligations reflects the possibility that some employees may leave without receiving profit-sharing payments. Paragraph 23 provides further conditions that are to be satisfied before an entity can recognize the expected cost of performance-related payments, bonus payments, and profit-sharing payments.

22. An entity may have no legal obligation to pay a bonus. Nevertheless, in some cases, an entity has a practice of paying bonuses. In such cases, the entity has a constructive obligation because the entity has no realistic alternative but to pay the bonus. The measurement of the constructive obligation reflects the possibility that some employees may leave without receiving a bonus.

23. An entity can make a reliable estimate of its legal or constructive obligation under a performance-related payment scheme, bonus plan, or profit-sharing scheme when, and only when:

    (a) The formal terms of the plan contain a formula for determining the amount of the benefit;

    (b) The entity determines the amounts to be paid before the financial statements are authorized for issue; or

    (c) Past practice gives clear evidence of the amount of the entity’s constructive obligation.

24. An obligation under bonus plans and profit-sharing plans results from employee service, and is recognized as an expense in surplus or deficit.

25. If bonus payments and profit shares are not due wholly within twelve months after the end of the period in which the employees render the related service, those payments are other long-term employee benefits (see paragraphs 147–153).

Disclosure

26. Although this Standard does not require specific disclosures about short-term employee benefits, other Standards may require disclosures. For example, IPSAS 20 requires disclosures of the aggregate remuneration of key management personnel and IPSAS 1 requires the disclosure of information about employee benefits.

Post-employment Benefits—Distinction between Defined Contribution Plans and Defined Benefit Plans

27. Post-employment benefits include, for example:

    (a) Retirement benefits, such as pensions; and

    (b) Other post-employment benefits, such as post-employment life insurance, and post-employment medical care.

    Arrangements whereby an entity provides post-employment benefits are post-employment benefit plans. An entity applies this Standard to all such arrangements, whether or not they involve the establishment of a separate entity, such as a pension scheme, superannuation scheme, or retirement benefit scheme, to receive contributions and to pay benefits.

28. Post-employment benefit plans are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan, as derived from its principal terms and conditions. In order to be classified as a defined contribution plan a post-employment benefit plan must require the entity to pay fixed contributions into a separate entity. Under defined contribution plans:

    (a) The entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurance company, together with investment returns arising from the contributions; and

    (b) In consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.

29. Examples of cases where an entity's obligation is not limited to the amount that it agrees to contribute to the fund are when the entity has a legal or constructive obligation through:

    (a) A plan benefit formula that is not linked solely to the amount of contributions;

    (b) A guarantee, either indirectly through a plan or directly, of a specified return on contributions; or

    (c) Those informal practices that give rise to a constructive obligation. For example, a constructive obligation may arise where an entity has a history of increasing benefits for former employees to keep pace with inflation, even where there is no legal obligation to do so.

30. Under defined benefit plans:

    (a) The entity's obligation is to provide the agreed benefits to current and former employees; and

    (b) Actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity. If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

31. Unlike defined contribution plans, the definition of a defined benefit plan does not require the payment of contributions to a separate entity. Paragraphs 32–53 below explain the distinction between defined contribution plans and defined benefit plans in the context of multi-employer plans, state plans, composite social security programs, and insured benefits.

Multi-Employer Plans

32. **An entity shall classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any constructive obligation that goes beyond the formal terms). Where a multi-employer plan is a defined benefit plan, an entity shall:**

    (a) **Account for its proportionate share of the defined benefit obligation, plan assets, and cost associated with the plan in the same way as for any other defined benefit plan; and**

    (b) **Disclose the information required by paragraph 141.**

33. **When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall:**

    (a) **Account for the plan under paragraphs 55–57 as if it were a defined contribution plan;**

(b) **Disclose:**

(i) **The fact that the plan is a defined benefit plan; and**

(ii) **The reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan; and**

(c) **To the extent that a surplus or deficit in the plan may affect the amount of future contributions, disclose in addition:**

(i) **Any available information about that surplus or deficit;**

(ii) **The basis used to determine that surplus or deficit; and**

(iii) **The implications, if any, for the entity.**

34. One example of a defined benefit multi-employer plan is where:

(a) The plan is financed on a pay-as-you-go basis, such that contributions of employers and/or employees are set at a level that is expected to be sufficient to pay the benefits falling due in the same period, and future benefits earned during the current period will be paid out of future contributions; and

(b) Employees' benefits are determined by the length of their service and the participating entities have no realistic means of withdrawing from the plan without paying a contribution for the benefits earned by employees up to the date of withdrawal.

Such a plan creates actuarial risk for the entity; if the ultimate cost of benefits already earned at the reporting date is more than expected, the entity will have to either increase its contributions or persuade employees to accept a reduction in benefits. Therefore, such a plan is a defined benefit plan.

35. Where sufficient information is available about a multi-employer plan that is a defined benefit plan, an entity accounts for its proportionate share of the defined benefit obligation, plan assets, and post-employment benefit cost associated with the plan in the same way as for any other defined benefit plan. However, there may be cases where an entity may not be able to identify its share of the underlying financial position and performance of the plan with sufficient reliability for accounting purposes. This may occur if:

(a) The entity does not have access to information about the plan that satisfies the requirements of this Standard; or

(b) The plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets, and cost to individual entities participating in the plan.

In those cases, an entity accounts for the plan as if it were a defined contribution plan, and discloses the additional information required by paragraph 33.

36. There may be a contractual agreement between the multi-employer plan and its participant entities that determines how the surplus in the plan will be distributed to the participant entities (or the deficit funded). A participant in a multi-employer plan with such an agreement that accounts for the plan as a defined contribution plan in accordance with paragraph 33 recognizes the asset or liability that arises from the contractual agreement, and the resulting revenue or expense in surplus or deficit.

37. IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* requires an entity to disclose information about some contingent liabilities. In the context of a multi-employer plan, a contingent liability may arise from, for example:

    (a) Actuarial losses relating to other participating entities because each entity that participates in a multi-employer plan shares in the actuarial risks of every other participating entity; or

    (b) Any responsibility under the terms of a plan to finance any shortfall in the plan if other entities cease to participate.

38. Multi-employer plans are distinct from group administration plans. A group administration plan is merely an aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes and reduce investment management and administration costs, but the claims of different employers are segregated for the sole benefit of their own employees. Group administration plans pose no particular accounting problems because information is readily available to treat them in the same way as any other single employer plan and because such plans do not expose the participating entities to actuarial risks associated with the current and former employees of other entities. The definitions in this Standard require an entity to classify a group administration plan as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan (including any constructive obligation that goes beyond the formal terms).

Defined Benefit Plans where the Participating Entities are under Common Control

39. Defined benefit plans that share risks between various entities under common control, for example, controlling and controlled entities, are not multi-employer plans.

40. An entity participating in such a plan obtains information about the plan as a whole, measured in accordance with this Standard on the basis of assumptions that apply to the plan as a whole. If there is a contractual agreement, binding

arrangement, or stated policy for charging the net defined benefit cost for the plan as a whole measured in accordance with this Standard to individual entities within the economic entity, the entity shall, in its separate or individual financial statements, recognize the net defined benefit cost so charged. If there is no such agreement, arrangement, or policy, the net defined benefit cost shall be recognized in the separate or individual financial statements of the entity that is legally the sponsoring employer for the plan. The other entities shall, in their separate or individual financial statements, recognize a cost equal to their contribution payable for the period.

41. There are cases in the public sector where a controlling entity and one or more controlled entities participate in a defined benefit plan. Unless there is a contractual agreement, binding arrangement, or stated policy, as specified in paragraph 40, the controlled entity accounts on a defined contribution basis and the controlling entity accounts on a defined benefit basis in its consolidated financial statements. The controlled entity also discloses that it accounts on a defined contribution basis in its separate financial statements. A controlled entity that accounts on a defined contribution basis also provides details of the controlling entity, and states that, in the controlling entity's consolidated financial statements, accounting is on a defined benefit basis. The controlled entity also makes the disclosures required in paragraph 42.

42. **Participation in such a plan is a related party transaction for each individual entity. An entity shall therefore, in its separate or individual financial statements, make the following disclosures:**

    (a) **The contractual agreement, binding arrangement, or stated policy for charging the net defined benefit cost or the fact that there is no such policy.**

    (b) **The policy for determining the contribution to be paid by the entity.**

    (c) **If the entity accounts for an allocation of the net defined benefit cost in accordance with paragraph 40, all the information about the plan as a whole in accordance with paragraphs 140–142.**

    (d) **If the entity accounts for the contribution payable for the period in accordance with paragraph 40, the information about the plan as a whole required in accordance with paragraphs 141(b)–(e), (j), (n), (o), (q), and 142. The other disclosures required by paragraph 141 do not apply.**

State Plans

43. **An entity shall account for post-employment benefits under state plans in the same way as for a multi-employer plan (see paragraphs 32 and 33).**

44. State plans are established by legislation to cover all entities (or all entities in a particular category, for example, a specific industry) and are operated by national, state, or local government or by another body (for example, an agency created specifically for this purpose). This Standard deals only with employee benefits of the entity, and does not address accounting for any obligations under state plans related to employees and past employees of entities that are not controlled by the reporting entity. While governments may establish state plans and provide benefits to employees of private sector entities and/or self-employed individuals, obligations arising in respect of such plans are not addressed in this Standard.

45. Many state plans are funded on a pay-as-you-go basis: contributions are set at a level that is expected to be sufficient to pay the required benefits falling due in the same period; future benefits earned during the current period will be paid out of future contributions. Entities covered by state plans account for those plans as either defined contribution or defined benefit plans. The accounting treatment depends upon whether the entity has a legal or constructive obligation to pay future benefits. If an entity's only obligation is to pay the contributions as they fall due, and the entity has no obligation to pay future benefits, it accounts for that state plan as a defined contribution plan.

46. A state plan may be classified as a defined contribution plan by a controlled entity. However, it is a rebuttable presumption that the state plan will be characterized as a defined benefit plan by the controlling entity. Where that presumption is rebutted the state plan is accounted for as a defined contribution plan.

Composite Social Security Programs

47. **A reporting entity shall account for post-employment benefits under composite social security programs in the same way as for a multi-employer plan (see paragraphs 32 and 33).**

48. Composite social security programs are established by legislation and provide benefits to individuals who have satisfied eligibility criteria. Such criteria principally include a requirement that an individual has attained a retirement age laid down in legislation. There may also be other criteria related to factors such as income and personal wealth. In some jurisdictions, the composite social security program may also operate to provide benefits as consideration in exchange for employment services rendered by individuals. This Standard only addresses obligations in composite social security programs that arise as consideration in exchange for service rendered by employees and past employees of the reporting entity. This Standard requires a reporting entity to account for obligations for employee benefits that arise under composite social security programs as for a multi-employer plan in accordance with paragraphs 32 and 33.

49. For an economic entity, such as the whole-of-government level, the accounting treatment for obligations for employee benefits under composite social security programs depends upon whether the component of that program operating to provide post-employment benefits to employees of the economic entity is characterized as a defined contribution or a defined benefit plan. In making this judgment, the factors highlighted in paragraph 35 are considered.

Insured Benefits

50. **An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly or indirectly through the plan) a legal or constructive obligation to either:**

   (a) **Pay the employee benefits directly when they fall due; or**

   (b) **Pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.**

   If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

51. The benefits insured by an insurance contract need not have a direct or automatic relationship with the entity's obligation for employee benefits. Post-employment benefit plans involving insurance contracts are subject to the same distinction between accounting and funding as other funded plans.

52. Where an entity funds a post-employment benefit obligation by contributing to an insurance policy under which the entity (either directly, indirectly through the plan, through the mechanism for setting future premiums, or through a related party relationship with the insurer) retains a legal or constructive obligation, the payment of the premiums does not amount to a defined contribution arrangement. It follows that the entity:

   (a) Accounts for a qualifying insurance policy as a plan asset (see paragraph 10); and

   (b) Recognizes other insurance policies as reimbursement rights (if the policies satisfy the criteria in paragraph 121).

53. Where an insurance policy (a) is in the name of a specified plan participant or a group of plan participants, and (b) the entity does not have any legal or constructive obligation to cover any loss on the policy, the entity has no obligation to pay benefits to the employees, and the insurer has sole responsibility for paying the benefits. The payment of fixed premiums under such contracts is, in substance, the settlement of the employee benefit obligation, rather than an investment to meet the obligation. Consequently, the

entity no longer has an asset or a liability. Therefore, an entity treats such payments as contributions to a defined contribution plan.

Post-employment Benefits—Defined Contribution Plans

54. Accounting for defined contribution plans is straightforward because the reporting entity's obligation for each period is determined by the amounts to be contributed for that period. Consequently, no actuarial assumptions are required to measure the obligation or the expense, and there is no possibility of any actuarial gain or loss. Moreover, the obligations are measured on an undiscounted basis, except where they do not fall due wholly within twelve months after the end of the period in which the employees render the related service.

Recognition and Measurement

55. **When an employee has rendered service to an entity during a period, the entity shall recognize the contribution payable to a defined contribution plan in exchange for that service:**

    (a) **As a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the reporting date, an entity shall recognize that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and**

    (b) **As an expense, unless another Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, IPSAS 12 and IPSAS 17.)**

56. **Where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they shall be discounted using the discount rate specified in paragraph 91.**

Disclosure

57. **An entity shall disclose the amount recognized as an expense for defined contribution plans.**

58. Where required by IPSAS 20, an entity discloses information about contributions to defined contribution plans for key management personnel.

Post-employment Benefits—Defined Benefit Plans

59. Accounting for defined benefit plans is complex, because actuarial assumptions are required to measure the obligation and the expense, and there is a possibility of actuarial gains and losses. Moreover, the obligations are

measured on a discounted basis, because they may be settled many years after the employees render the related service.

Recognition and Measurement

60. Defined benefit plans may be unfunded, or they may be wholly or partly funded by contributions by an entity, and sometimes its employees, into an entity or fund that is legally separate from the reporting entity and from which the employee benefits are paid. The payment of funded benefits when they fall due depends not only on the financial position and the investment performance of the fund but also on an entity's ability (and willingness) to make good any shortfall in the fund's assets. Therefore, the entity is, in substance, underwriting the actuarial and investment risks associated with the plan. Consequently, the expense recognized for a defined benefit plan is not necessarily the amount of the contribution due for the period.

61. Accounting by an entity for defined benefit plans involves the following steps:

    (a) Using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an entity to determine how much benefit is attributable to the current and prior periods (see paragraphs 80–84), and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that will influence the cost of the benefit (see paragraphs 85–104);

    (b) Discounting that benefit using the Projected Unit Credit Method in order to determine the present value of the defined benefit obligation and the current service cost (see paragraphs 77–79);

    (c) Determining the fair value of any plan assets (see paragraphs 118–120);

    (d) Determining the total amount of actuarial gains and losses and the amount of those actuarial gains and losses to be recognized (see paragraphs 105–111);

    (e) Where a plan has been introduced or changed, determining the resulting past service cost (see paragraphs 112–117); and

    (f) Where a plan has been curtailed or settled, determining the resulting gain or loss (see paragraphs 129–135). Where an entity has more than one defined benefit plan, the entity applies these procedures for each material plan separately. For example, a State Government responsible for educational and health services and a number of other services may have separate plans for teachers, healthcare workers, and other employees.

62. In some cases, estimates, averages, and computational short cuts may provide a reliable approximation of the detailed computations illustrated in this Standard.

Accounting for the Constructive Obligation

63. **An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.**

64. The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to cancel a plan if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for post-employment benefits assumes that an entity that is currently promising such benefits will continue to do so over the remaining working lives of employees.

Statement of Financial Position

65. **The amount recognized as a defined benefit liability shall be the net total of the following amounts:**

    (a) **The present value of the defined benefit obligation at the reporting date (see paragraph 77);**

    (b) **Plus any actuarial gains (less any actuarial losses) not recognized because of the treatment set out in paragraphs 105 and 106;**

    (c) **Minus any past service cost not yet recognized (see paragraph 112); and**

    (d) **Minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 118–120).**

66. The present value of the defined benefit obligation is the gross obligation, before deducting the fair value of any plan assets.

67. **An entity shall determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the reporting date.**

68. This Standard encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material post-employment benefit obligations. For practical reasons, an entity may request a qualified actuary to

carry out a detailed valuation of the obligation before the reporting date. Nevertheless, the results of that valuation are updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the reporting date.

69. **The amount determined under paragraph 65 may be negative (an asset). An entity shall measure the resulting asset at the lower of:**

(a) **The amount determined under paragraph 65; and**

(b) **The total of:**

(i) **Any cumulative unrecognized net actuarial losses and past service cost (see paragraphs 105, 106 and 112); and**

(ii) **The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits shall be determined using the discount rate specified in paragraph 91.**

70. **The application of paragraph 69 shall not result in a gain being recognized solely as a result of an actuarial loss or past service cost in the current period, or in a loss being recognized solely as a result of an actuarial gain in the current period. The entity shall therefore recognize immediately under paragraph 65 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 69(b):**

(a) **Net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 69(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period shall be recognized immediately under paragraph 65.**

(b) **Net actuarial gains of the current period after the deduction of past service cost of the current period, to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 69(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period shall be recognized immediately under paragraph 65.**

71. Paragraph 70 applies to an entity only if it has, at the beginning or end of the accounting period, a surplus[1] in a defined benefit plan and cannot, based on the current terms of the plan, recover that surplus fully through refunds or reductions in future contributions. In such cases, past service cost and actuarial losses that arise in the period, the recognition of which is deferred under paragraph 65, will increase the amount specified in paragraph 69(b)(i). If that increase is not offset by an equal decrease in the present value of economic benefits that qualify for recognition under paragraph 69(b)(ii), there will be an increase in the net total specified by paragraph 69(b) and, hence, a recognized gain. Paragraph 70 prohibits the recognition of a gain in these circumstances. The opposite effect arises with actuarial gains that arise in the period, the recognition of which is deferred under paragraph 65, to the extent that the actuarial gains reduce cumulative unrecognized actuarial losses. Paragraph 70 prohibits the recognition of a loss in these circumstances. For examples of the application of this paragraph, see Illustrative Examples, paragraphs IE8–IE30.

72. An asset may arise where a defined benefit plan has been overfunded, or in certain cases where actuarial gains are recognized. An entity recognizes an asset in such cases because:

    (a) The entity controls a resource, which is the ability to use the surplus to generate future benefits;

    (b) That control is a result of past events (contributions paid by the entity and service rendered by the employee); and

    (c) Future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit.

73. The limit in paragraph 69(b) does not override the delayed recognition of certain actuarial losses (see paragraphs 105 and 106) and certain past service cost (see paragraph 112), other than as specified in paragraph 70. Paragraph 141(f)(iii) requires an entity to disclose any amount not recognized as an asset because of the limit in paragraph 69(b).

Statement of Financial Performance

74. **An entity shall recognize the net total of the following amounts in surplus or deficit, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:**

    (a) **Current service cost (see paragraphs 76–104);**

    (b) **Interest cost (see paragraph 95);**

[1] A surplus is an excess of the fair value of the plan assets over the present value of the defined benefit obligation.

(c) **The expected return on any plan assets (see paragraphs 125–127) and on any reimbursement rights (see paragraph 121);**

(d) **Actuarial gains and losses, as required in accordance with the entity's accounting policy (see paragraphs 105–109);**

(e) **Past service cost (see paragraph 112);**

(f) **The effect of any curtailments or settlements (see paragraphs 129 and 130); and**

(g) **The effect of the limit in paragraph 69(b), unless it is recognized in the Statement of Changes in Net Assets/Equity in accordance with paragraph 108.**

75. Other Standards require the inclusion of certain employee benefit costs within the cost of assets, such as inventories or property, plant, and equipment (see IPSAS 12 and IPSAS 17). Any post-employment benefit costs included in the cost of such assets include the appropriate proportion of the components listed in paragraph 74.

Recognition and Measurement—Present Value of Defined Benefit Obligations and Current Service Cost

76. The ultimate cost of a defined benefit plan may be influenced by many variables, such as final salaries, employee turnover and mortality, medical cost trends and, for a funded plan, the investment earnings on the plan assets. The ultimate cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time. In order to measure the present value of the post-employment benefit obligations and the related current service cost, it is necessary to:

(a) Apply an actuarial valuation method (see paragraphs 77–79);

(b) Attribute benefit to periods of service (see paragraphs 80–84); and

(c) Make actuarial assumptions (see paragraphs 85–104).

Actuarial Valuation Method

77. **An entity shall use the Projected Unit Credit Method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.**

78. The Projected Unit Credit Method (sometimes known as the accrued benefit method prorated on service or as the benefit/years of service method) sees each period of service as giving rise to an additional unit of benefit entitlement (see paragraphs 80–84), and measures each unit separately to build up the final obligation (see paragraphs 85–104).

79. An entity discounts the whole of a post-employment benefit obligation, even if part of the obligation falls due within twelve months of the reporting date.

Attributing Benefit to Periods of Service

80. **In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an entity shall attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:**

    (a) **The date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service); until**

    (b) **The date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.**

81. The Projected Unit Credit Method requires an entity to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations). An entity attributes benefit to periods in which the obligation to provide post-employment benefits arises. That obligation arises as employees render services in return for post-employment benefits that an entity expects to pay in future reporting periods. Actuarial techniques allow an entity to measure that obligation with sufficient reliability to justify recognition of a liability.

82. Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words, they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive reporting date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy any vesting requirements. Similarly, although certain post-employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

83. The obligation increases until the date when further service by the employee will lead to no material amount of further benefits. Therefore, all benefit is attributed to periods ending on or before that date. Benefit is attributed to

individual accounting periods under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity attributes benefit on a straight-line basis until the date when further service by the employee will lead to no material amount of further benefits. That is because the employee's service throughout the entire period will ultimately lead to benefit at that higher level.

84. Where the amount of a benefit is a constant proportion of final salary for each year of service, future salary increases will affect the amount required to settle the obligation that exists for service before the reporting date, but do not create an additional obligation. Therefore:

(a) For the purpose of paragraph 80(b), salary increases do not lead to further benefits, even though the amount of the benefits is dependent on final salary; and

(b) The amount of benefit attributed to each period is a constant proportion of the salary to which the benefit is linked.

Actuarial Assumptions

85. **Actuarial assumptions shall be unbiased and mutually compatible.**

86. Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing post-employment benefits. Actuarial assumptions comprise:

(a) Demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:

(i) Mortality, both during and after employment;

(ii) Rates of employee turnover, disability, and early retirement;

(iii) The proportion of plan members with dependants who will be eligible for benefits; and

(iv) Claim rates under medical plans.

(b) Financial assumptions, dealing with items such as:

(i) The discount rate (see paragraphs 91–95);

(ii) Future salary and benefit levels (see paragraphs 96–100);

(iii) In the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments (see paragraphs 101–104); and

(iv) The expected rate of return on plan assets (see paragraphs 125–127).

87. Actuarial assumptions are unbiased if they are neither imprudent nor excessively conservative.

88. Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, rates of salary increase, the return on plan assets, and discount rates. For example, all assumptions that depend on a particular inflation level (such as assumptions about interest rates and salary and benefit increases) in any given future period assume the same inflation level in that period.

89. An entity determines the discount rate and other financial assumptions in nominal (stated) terms, unless estimates in real (inflation-adjusted) terms are more reliable, for example, in a hyperinflationary economy (see IPSAS 10, *Financial Reporting in Hyperinflationary Economies*), or where the benefit is index-linked, and there is a deep market in index-linked bonds of the same currency and term.

90. **Financial assumptions shall be based on market expectations, at the reporting date, for the period over which the obligations are to be settled.**

Actuarial Assumptions—Discount Rate

91. **The rate used to discount post-employment benefit obligations (both funded and unfunded) shall reflect the time value of money. The currency and term of the financial instrument selected to reflect the time value of money shall be consistent with the currency and estimated term of the post-employment benefit obligations.**

92. One actuarial assumption that has a material effect is the discount rate. The discount rate reflects the time value of money but not the actuarial or investment risk. Furthermore, the discount rate does not reflect the entity-specific credit risk borne by the entity's creditors, nor does it reflect the risk that future experience may differ from actuarial assumptions.

93. The discount rate reflects the estimated timing of benefit payments. In practice, an entity often achieves this by applying a single weighted average discount rate that reflects the estimated timing and amount of benefit payments, and the currency in which the benefits are to be paid.

94. An entity makes a judgment whether the discount rate that reflects the time value of money is best approximated by reference to market yields at the reporting date on government bonds, high quality corporate bonds, or by another financial instrument. In some jurisdictions, market yields at the reporting date on government bonds will provide the best approximation of the time value of money. However, there may be jurisdictions in which this is not the case, for example, jurisdictions where there is no deep market in government bonds, or in which market yields at the reporting date on government bonds do not reflect the time value of money. In such cases, the

reporting entity determines the rate by another method, such as by reference to market yields on high quality corporate bonds. There may also be circumstances where there is no deep market in government bonds or high quality corporate bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments. In such circumstances, an entity uses current market rates of the appropriate term to discount shorter term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve. The total present value of a defined benefit obligation is unlikely to be particularly sensitive to the discount rate applied to the portion of benefits that is payable beyond the final maturity of the available financial instrument, such as government bonds or corporate bonds.

95. Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period, taking account of any material changes in the obligation. The present value of the obligation will differ from the liability recognized in the statement of financial position, (a) because the liability is recognized after deducting the fair value of any plan assets, and (b) because some actuarial gains and losses, and some past service cost, are not recognized immediately. The Illustrative Examples, paragraphs IE1–IE6, illustrate the computation of interest cost, among other things.

Actuarial Assumptions—Salaries, Benefits and Medical Costs

96. **Post-employment benefit obligations shall be measured on a basis that reflects:**

(a) **Estimated future salary increases;**

(b) **The benefits set out in the terms of the plan (or resulting from any constructive obligation that goes beyond those terms) at the reporting date; and**

(c) **Estimated future changes in the level of any state benefits that affect the benefits payable under a defined benefit plan, if, and only if, either:**

(i) **Those changes were enacted before the reporting date; or**

(ii) **Past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.**

97. Estimates of future salary increases take account of inflation, seniority, promotion, and other relevant factors, such as supply and demand in the employment market.

98. If the formal terms of a plan (or a constructive obligation that goes beyond those terms) require an entity to change benefits in future periods, the measurement of the obligation reflects those changes. This is the case when, for example:

    (a) The entity has a past history of increasing benefits, for example, to mitigate the effects of inflation, and there is no indication that this practice will change in the future; or

    (b) Actuarial gains have already been recognized in the financial statements, and the entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants (see paragraph 114(c)).

99. Actuarial assumptions do not reflect future benefit changes that are not set out in the formal terms of the plan (or a constructive obligation) at the reporting date. Such changes will result in:

    (a) Past service cost, to the extent that they change benefits for service before the change; and

    (b) Current service cost for periods after the change, to the extent that they change benefits for service after the change.

100. Some post-employment benefits are linked to variables, such as the level of benefit entitlements from social security pensions or state medical care. The measurement of such benefits reflects expected changes in such variables, based on past history and other reliable evidence.

101. **Assumptions about medical costs shall take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.**

102. Measurement of post-employment medical benefits requires assumptions about the level and frequency of future claims and the cost of meeting those claims. An entity estimates future medical costs on the basis of historical data about the entity’s own experience, supplemented where necessary by historical data from other entities, insurance companies, medical providers, or other sources. Estimates of future medical costs consider the effect of technological advances, changes in health care utilization or delivery patterns, and changes in the health status of plan participants.

103. The level and frequency of claims is particularly sensitive to the age, health status, and gender of employees (and their dependants), and may be sensitive to other factors such as geographical location. Therefore, historical data is adjusted to the extent that the demographic mix of the population differs from that of the population used as a basis for the historical data. It is also adjusted where there is reliable evidence that historical trends will not continue.

104. Some post-employment health care plans require employees to contribute to the medical costs covered by the plan. Estimates of future medical costs take account of any such contributions, based on the terms of the plan at the reporting date (or based on any constructive obligation that goes beyond those terms.) Changes in those employee contributions result in past service cost or, where applicable, curtailments. The cost of meeting claims may be reduced by benefits from state or other medical providers (see paragraphs 96(c) and 100.)

Actuarial Gains and Losses

105. **In measuring its defined benefit liability in accordance with paragraph 65, an entity shall, subject to paragraph 70, recognize a portion (as specified in paragraph 106) of its actuarial gains and losses as revenue or expense if the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded the greater of:**

(a) **10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and**

(b) **10% of the fair value of any plan assets at that date.**

These limits shall be calculated and applied separately for each defined benefit plan.

106. **The portion of actuarial gains and losses to be recognized for each defined benefit plan is the excess determined in accordance with paragraph 105, divided by the expected average remaining working lives of the employees participating in that plan. However, an entity may adopt any systematic method that results in faster recognition of actuarial gains and losses, provided that the same basis is applied to both gains and losses, and the basis is applied consistently from period to period. An entity may apply such systematic methods to actuarial gains and losses even if they are within the limits specified in paragraph 105.**

107. **If, as permitted by paragraph 106, an entity adopts a policy of recognizing actuarial gains and losses in the period in which they occur, it may recognize them as a separate item directly in net assets/equity, in accordance with paragraphs 108 and 109, providing it does so for:**

(a) **All of its defined benefit plans; and**

(b) **All of its actuarial gains and losses.**

108. Actuarial gains and losses recognized directly in net assets/equity as permitted by paragraph 107 shall be presented in the statement of changes in net assets/equity in accordance with paragraph 118(b) of IPSAS 1.

109. An entity that recognizes actuarial gains and losses in accordance with paragraph 107 shall also recognize any adjustments arising from the limit in

paragraph 69(b) outside surplus or deficit in the statement of changes in net assets/equity, in accordance with paragraph 118(b) of IPSAS 1. Actuarial gains and losses and adjustments arising from the limit in paragraph 69(b) that have been recognized directly in the statement of changes in net assets/equity shall be recognized immediately in accumulated surpluses or deficits. They shall not be recognized in surplus or deficit in a subsequent period.

110. Actuarial gains and losses may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets. Causes of actuarial gains and losses include, for example:

(a) Unexpectedly high or low rates of employee turnover, early retirement or mortality, or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases), or medical costs;

(b) The effect of changes in estimates of future employee turnover, early retirement, or mortality, or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases), or medical costs;

(c) The effect of changes in the discount rate; and

(d) Differences between the actual return on plan assets and the expected return on plan assets (see paragraphs 125–127).

111. In the long term, actuarial gains and losses may offset one another. Therefore, estimates of post-employment benefit obligations may be viewed as a range (or corridor) around the best estimate. An entity is permitted, but not required, to recognize actuarial gains and losses that fall within that range. This Standard requires an entity to recognize, as a minimum, a specified portion of the actuarial gains and losses that fall outside a corridor of plus or minus 10%. The Illustrative Examples, paragraphs IE1–IE6, illustrate the treatment of actuarial gains and losses, among other things. The Standard also permits systematic methods of faster recognition, provided that those methods satisfy the conditions set out in paragraph 106. Such permitted methods include, for example, immediate recognition of all actuarial gains and losses, both within and outside the corridor.

Past Service Cost

112. **In measuring its defined benefit liability under paragraph 65, an entity shall, subject to paragraph 70, recognize past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an entity shall recognize past service cost immediately.**

113. Past service cost arises when an entity introduces a defined benefit plan that attributes benefits to past service or changes the benefits payable for past service under an existing defined benefit plan. Such changes are in return for employee service over the period until the benefits concerned are vested. Therefore, the entity recognizes past service cost over that period, regardless of the fact that the cost refers to employee service in previous periods. The entity measures past service cost as the change in the liability resulting from the amendment (see paragraph 77). Negative past service cost arises when an entity changes the benefits attributable to past service so that the present value of the defined benefit obligation decreases.

114. Past service cost excludes:

(a) The effect of differences between actual and previously assumed salary increases on the obligation to pay benefits for service in prior years (there is no past service cost because actuarial assumptions allow for projected salaries);

(b) Under and over estimates of discretionary pension increases when an entity has a constructive obligation to grant such increases (there is no past service cost because actuarial assumptions allow for such increases);

(c) Estimates of benefit improvements that result from actuarial gains that have been recognized in the financial statements if the entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants, even if the benefit increase has not yet been formally awarded (the resulting increase in the obligation is an actuarial loss and not past service cost, see paragraph 98(b));

(d) The increase in vested benefits when, in the absence of new or improved benefits, employees complete vesting requirements (there is no past service cost because the entity recognized the estimated cost of benefits as current service cost as the service was rendered); and

(e) The effect of plan amendments that reduce benefits for future service (a curtailment).

115. An entity establishes the amortization schedule for past service cost when the benefits are introduced or changed. It would be impracticable to maintain the detailed records needed to identify and implement subsequent changes in that amortization schedule. Moreover, the effect is likely to be material only where there is a curtailment or settlement. Therefore, an entity amends the amortization schedule for past service cost only if there is a curtailment or settlement.

116. Where an entity reduces benefits payable under an existing defined benefit plan, the resulting reduction in the defined benefit liability is recognized as

(negative) past service cost over the average period until the reduced portion of the benefits becomes vested.

117. Where an entity reduces certain benefits payable under an existing defined benefit plan and, at the same time, increases other benefits payable under the plan for the same employees, the entity treats the change as a single net change.

Recognition and Measurement—Plan Assets

Fair Value of Plan Assets

118. The fair value of any plan assets is deducted in determining the amount recognized in the statement of financial position under paragraph 65. When no market price is available, the fair value of plan assets is estimated, for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).

119. Plan assets exclude unpaid contributions due from the reporting entity to the fund, as well as any non-transferable financial instruments issued by the entity and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.

120. Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations, as described in paragraph 65 (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

Reimbursements

121. **When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an entity shall recognize its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In all other respects, an entity shall treat that asset in the same way as plan assets. In the statement of financial performance, the expense relating to a defined benefit plan may be presented net of the amount recognized for a reimbursement.**

122. Sometimes, an entity is able to look to another party, such as an insurer, to pay part or all of the expenditure required to settle a defined benefit obligation. Qualifying insurance policies, as defined in paragraph 10, are plan assets. An entity accounts for qualifying insurance policies in the same way as

for all other plan assets, and paragraph 121 does not apply (see paragraphs 50–53 and 120).

123 When an insurance policy is not a qualifying insurance policy, that insurance policy is not a plan asset. Paragraph 121 deals with such cases: the entity recognizes its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability recognized under paragraph 65; in all other respects, the entity treats that asset in the same way as plan assets. In particular, the defined benefit liability recognized under paragraph 65 is increased (reduced) to the extent that net cumulative actuarial gains (losses) on the defined benefit obligation and on the related reimbursement right remain unrecognized under paragraphs 105 and 106. Paragraph 141(f)(iv) requires the entity to disclose a brief description of the link between the reimbursement right and the related obligation.

124. If the right to reimbursement arises under an insurance policy or a legally binding agreement that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to be the present value of the related obligation, as described in paragraph 65 (subject to any reduction required if the reimbursement is not recoverable in full).

Return on Plan Assets

125. The expected return on plan assets is one component of the expense recognized in the statement of financial performance. The difference between the expected return on plan assets and the actual return on plan assets is an actuarial gain or loss; it is included with the actuarial gains and losses on the defined benefit obligation in determining the net amount that is compared with the limits of the 10% corridor specified in paragraph 105.

126. The expected return on plan assets is based on market expectations, at the beginning of the period, for returns over the entire life of the related obligation. The expected return on plan assets reflects changes in the fair value of plan assets held during the period as a result of actual contributions paid into the fund and actual benefits paid out of the fund.

127. In determining the expected and actual return on plan assets, an entity deducts expected administration costs, other than those included in the actuarial assumptions used to measure the obligation.

Entity Combinations

128. In determining the assets and liabilities to be recognized related to post-employment benefits in an entity combination, an entity considers the international or national accounting standard dealing with entity combinations.

Curtailments and Settlements

129. **An entity shall recognize gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss on a curtailment or settlement shall comprise:**

    (a) **Any resulting change in the present value of the defined benefit obligation;**

    (b) **Any resulting change in the fair value of the plan assets; and**

    (c) **Any related actuarial gains and losses and past service cost that, under paragraphs 105 and 112, had not previously been recognized.**

130. **Before determining the effect of a curtailment or settlement, an entity shall remeasure the obligation (and the related plan assets, if any) using current actuarial assumptions (including current market interest rates and other current market prices).**

131. A curtailment occurs when an entity either:

    (a) Is demonstrably committed to make a significant reduction in the number of employees covered by a plan; or

    (b) Amends the terms of a defined benefit plan so that a significant element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.

    A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan, or a reduction in the extent to which future salary increases are linked to the benefits payable for past service. Curtailments are often linked with a restructuring. When this is the case, an entity accounts for a curtailment at the same time as for a related restructuring.

131A. When a plan amendment reduces benefits, only the effect of the reduction for future service is a curtailment. The effect of any reduction for past service is a negative past service cost.

132. A settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan, for example, when a lump-sum cash payment is made to, or on behalf of, plan participants in exchange for their rights to receive specified post-employment benefits.

133. In some cases, an entity acquires an insurance policy to fund some or all of the employee benefits relating to employee service in the current and prior periods. The acquisition of such a policy is not a settlement if the entity retains a legal or constructive obligation (see paragraph 50) to pay further amounts if the insurer does not pay the employee benefits specified in the

insurance policy. Paragraphs 121–124 deal with the recognition and measurement of reimbursement rights under insurance policies that are not plan assets.

134. A settlement occurs together with a curtailment if a plan is terminated such that the obligation is settled and the plan ceases to exist. However, the termination of a plan is not a curtailment or settlement if the plan is replaced by a new plan that offers benefits that are, in substance, identical.

135. Where a curtailment relates to only some of the employees covered by a plan, or where only part of an obligation is settled, the gain or loss includes a proportionate share of the previously unrecognized past service cost and actuarial gains and losses. The proportionate share is determined on the basis of the present value of the obligations before and after the curtailment or settlement, unless another basis is more rational in the circumstances. For example, it may be appropriate to apply any gain arising on a curtailment or settlement of the same plan to first eliminate any unrecognized past service cost relating to the same plan.

Presentation

Offset

136. **An entity shall offset an asset relating to one plan against a liability relating to another plan when, and only when, the entity:**

  (a) **Has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and**

  (b) **Intends either to settle the obligations on a net basis, or to realize the surplus in one plan and settle its obligation under the other plan simultaneously.**

137. The offsetting criteria are similar to those established for financial instruments in IPSAS 28, *Financial Instruments: Presentation*.

Current/Non-Current Distinction

138. Some entities distinguish current assets and liabilities from non-current assets and liabilities. This Standard does not specify whether an entity should distinguish current and non-current portions of assets and liabilities arising from post-employment benefits.

Financial Components of Post-employment Benefit Costs

139. This Standard does not specify whether an entity should present current service cost, interest cost, and the expected return on plan assets as components of a single item of revenue or expense on the face of the statement of financial performance.

Disclosure

140. **An entity shall disclose information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period.**

141. **An entity shall disclose the following information about defined benefit plans:**

    (a) **The entity's accounting policy for recognizing actuarial gains and losses;**

    (b) **A general description of the type of plan;**

    (c) **A reconciliation of opening and closing balances of the present value of the defined benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:**

        (i) **Current service cost;**

        (ii) **Interest cost;**

        (iii) **Contributions by plan participants;**

        (iv) **Actuarial gains and losses;**

        (v) **Foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency;**

        (vi) **Benefits paid;**

        (vii) **Past service cost;**

        (viii) **Entity combinations;**

        (ix) **Curtailments; and**

        (x) **Settlements.**

    (d) **An analysis of the defined benefit obligation into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded;**

    (e) **A reconciliation of the opening and closing balances of the fair value of plan assets, and of the opening and closing balances of any reimbursement right recognized as an asset in accordance with paragraph 121 showing separately, if applicable, the effects during the period attributable to each of the following:**

        (i) **Expected return on plan assets;**

        (ii) **Actuarial gains and losses;**

(iii) **Foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency;**

(iv) **Contributions by the employer;**

(v) **Contributions by plan participants;**

(vi) **Benefits paid;**

(vii) **Entity combinations; and**

(viii) **Settlements.**

(f) **A reconciliation of the present value of the defined benefit obligation in (c) and the fair value of the plan assets in (e) to the assets and liabilities recognized in the statement of financial position, showing at least:**

(i) **The net actuarial gains or losses not recognized in the statement of financial position (see paragraph 105);**

(ii) **The past service cost not recognized in the statement of financial position (see paragraph 112);**

(iii) **Any amount not recognized as an asset, because of the limit in paragraph 69(b);**

(iv) **The fair value at the reporting date of any reimbursement right recognized as an asset in accordance with paragraph 121 (with a brief description of the link between the reimbursement right and the related obligation); and**

(v) **The other amounts recognized in the statement of financial position.**

(g) **The total expense recognized in the statement of financial performance for each of the following, and the line item(s) in which they are included:**

(i) **Current service cost;**

(ii) **Interest cost;**

(iii) **Expected return on plan assets;**

(iv) **Expected return on any reimbursement right recognized as an asset in accordance with paragraph 121;**

(v) **Actuarial gains and losses;**

(vi) **Past service cost;**

(vii) **The effect of any curtailment or settlement; and**

(viii) **The effect of the limit in paragraph 69(b).**

(h) **The total amount recognized in the statement of changes in net assets/equity for each of the following:**

(i) **Actuarial gains and losses; and**

(ii) **The effect of the limit in paragraph 69(b).**

(i) **For entities that recognize actuarial gains and losses in the statement of changes in net assets/equity in accordance with paragraph 107, the cumulative amount of actuarial gains and losses recognized in that statement;**

(j) **For each major category of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total plan assets;**

(k) **The amounts included in the fair value of plan assets for:**

(i) **Each category of the entity's own financial instruments; and**

(ii) **Any property occupied by, or other assets used by, the entity.**

(l) **A narrative description of the basis used to determine the overall expected rate of return on assets, including the effect of the major categories of plan assets;**

(m) **The actual return on plan assets, as well as the actual return on any reimbursement right recognized as an asset in accordance with paragraph 121;**

(n) **The principal actuarial assumptions used as at the reporting date, including, when applicable:**

(i) **The discount rates;**

(ii) **The basis on which the discount rate has been determined;**

(iii) **The expected rates of return on any plan assets for the periods presented in the financial statements;**

(iv) **The expected rates of return for the periods presented in the financial statements on any reimbursement right recognized as an asset in accordance with paragraph 121;**

(v) **The expected rates of salary increases (and of changes in an index or other variable specified in the formal or constructive terms of a plan as the basis for future benefit increases);**

(vi) **Medical cost trend rates; and**

(vii) **Any other material actuarial assumptions used.**

An entity shall disclose each actuarial assumption in absolute terms (for example, as an absolute percentage) and not just as a margin between different percentages or other variables;

(o) **The effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates on:**

(i) **The aggregate of the current service cost and interest cost components of net periodic post-employment medical costs; and**

(ii) **The accumulated post-employment benefit obligation for medical costs.**

For the purposes of this disclosure, all other assumptions shall be held constant. For plans operating in a high inflation environment, the disclosure shall be the effect of a percentage increase or decrease in the assumed medical cost trend rate of a significance similar to one percentage point in a low inflation environment;

(p) **The amounts for the current annual period and previous four annual periods of:**

(i) **The present value of the defined benefit obligation, the fair value of the plan assets, and the surplus or deficit in the plan; and**

(ii) **The experience adjustments arising on:**

a. **The plan liabilities expressed either as (1) an amount, or (2) a percentage of the plan liabilities at the reporting date; and**

b. **The plan assets expressed either as (1) an amount, or (2) a percentage of the plan assets at the reporting date.**

(q) **The employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the annual period beginning after the reporting date.**

142. Paragraph 141(b) requires a general description of the type of plan. Such a description distinguishes, for example, flat salary pension plans from final salary pension plans, and from post-employment medical plans. The description of the plan includes informal practices that give rise to constructive obligations included in the measurement of the defined benefit obligation in accordance with paragraph 63. Further detail is not required.

143. When an entity has more than one defined benefit plan, disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful. It may be useful to distinguish groupings by criteria such as the following:

(a) The geographical location of the plans; or

(b) Whether plans are subject to materially different risks, for example, by distinguishing flat salary pension plans from final salary pension plans, and from post-employment medical plans.

When an entity provides disclosures in total for a grouping of plans, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.

144. Paragraph 33 requires additional disclosures about multi-employer defined benefit plans that are treated as if they were defined contribution plans.

145. Where required by IPSAS 20, an entity discloses information about:

(a) Related party transactions with post-employment benefit plans; and

(b) Post-employment benefits for key management personnel.

146. Where required by IPSAS 19, an entity discloses information about contingent liabilities arising from post-employment benefit obligations.

Other Long-Term Employee Benefits

147. Other long-term employee benefits may include, for example:

(a) Long-term compensated absences such as long service or sabbatical leave;

(b) Jubilee or other long service benefits;

(c) Long-term disability benefits;

(d) Bonuses and profit sharing payable twelve months or more after the end of the period in which the employees render the related service;

(e) Deferred compensation paid twelve months or more after the end of the period in which it is earned; and

(f) Compensation payable by the entity until an individual enters new employment.

148. The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Furthermore, the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost. For these reasons, this Standard requires a simplified method of accounting for

other long-term employee benefits. This method differs from the accounting required for post-employment benefits as follows:

(a) Actuarial gains and losses are recognized immediately and no corridor is applied; and

(b) All past service cost is recognized immediately.

149. This Standard includes a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Where this presumption is rebutted, the entity considers whether some or all long-term disability payments should be accounted for in accordance with paragraphs 59–146.

Recognition and Measurement

150. **The amount recognized as a liability for other long-term employee benefits shall be the net total of the following amounts:**

(a) **The present value of the defined benefit obligation at the reporting date (see paragraph 77);**

(b) **Minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 118–120).**

In measuring the liability, an entity shall apply paragraphs 55–104, excluding paragraphs 65 and 74. An entity shall apply paragraph 121 in recognizing and measuring any reimbursement right.

151. **For other long-term employee benefits, an entity shall recognize the net total of the following amounts as expense or (subject to paragraph 69) revenue, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:**

(a) **Current service cost (see paragraphs 76–104);**

(b) **Interest cost (see paragraph 95);**

(c) **The expected return on any plan assets (see paragraphs 125–127) and on any reimbursement right recognized as an asset (see paragraph 121);**

(d) **Actuarial gains and losses, which shall all be recognized immediately;**

(e) **Past service cost, which shall all be recognized immediately; and**

(f) **The effect of any curtailments or settlements (see paragraphs 129 and 130).**

152. One form of other long-term employee benefit is long-term disability benefit. If the level of benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required, and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognized when an event occurs that causes a long-term disability. Paragraph 149 highlights the possibility that long-term disability benefit payments may be subject to a higher degree of uncertainty than other long-term employee benefits.

Disclosure

153. Although this Standard does not require specific disclosures about other long-term employee benefits, other Standards may require disclosures; for example, where the expense resulting from such benefits is material, and so would require disclosure in accordance with IPSAS 1. When required by IPSAS 20, an entity discloses information about other long-term employee benefits for key management personnel.

Termination Benefits

154. This Standard deals with termination benefits separately from other employee benefits, because the event which gives rise to an obligation is the termination rather than employee service.

Recognition

155. **An entity shall recognize termination benefits as a liability and an expense when, and only when, the entity is demonstrably committed to either:**

   (a) **Terminate the employment of an employee or group of employees before the normal retirement date; or**

   (b) **Provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.**

156. **An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan for the termination, and is without realistic possibility of withdrawal. The detailed plan shall include, as a minimum:**

   (a) **The location, function, and approximate number of employees whose services are to be terminated;**

   (b) **The termination benefits for each job classification or function; and**

(c) **The time at which the plan will be implemented. Implementation shall begin as soon as possible and the period of time to complete implementation shall be such that material changes to the plan are not likely.**

157. An entity may be committed, (a) by legislation, (b) by contractual or other agreements with employees or their representatives, or (c) by a constructive obligation based on business practice, custom, or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits. Termination benefits are typically lump-sum payments, but sometimes also include:

(a) Enhancement of retirement benefits or of other post-employment benefits, either indirectly through an employee benefit plan or directly; and

(b) Salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.

158. Some employee benefits are payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits are described in some countries as termination indemnities, or termination gratuities, they are post-employment benefits rather than termination benefits, and an entity accounts for them as post-employment benefits. Some entities provide a lower level of benefit for voluntary termination at the request of the employee (in substance, a post-employment benefit) than for involuntary termination at the request of the entity. The additional benefit payable on involuntary termination is a termination benefit.

159. Termination benefits do not provide an entity with future economic benefits, and are recognized as an expense immediately.

160. Where an entity recognizes termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits (see paragraph 129).

Measurement

161. **Where termination benefits fall due more than 12 months after the reporting date, they shall be discounted using the discount rate specified in paragraph 91.**

162. **In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.**

Disclosure

163. Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. As required by IPSAS 19, an entity discloses information about the contingent liability unless the possibility of an outflow in settlement is remote.

164. As required by IPSAS 1, an entity discloses the nature and amount of an expense if it is material. Termination benefits may result in an expense needing disclosure in order to comply with this requirement.

165. Where required by IPSAS 20, an entity discloses information about termination benefits for key management personnel.

First Time Adoption of this Standard

166. [Deleted]

167. [Deleted]

168. [Deleted]

169. [Deleted]

170. [Deleted]

171. [Deleted]

172. [Deleted]

173. [Deleted]

174. [Deleted]

175. [Deleted]

176. [Deleted]

Effective Date

177. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2011. Earlier adoption is encouraged. If an entity applies this Standard for a period beginning before January 1, 2011, it shall disclose that fact.**

177A. **Paragraphs 10, 11, 37, 113, 114, and 131 were amended and paragraph 131A was added by *Improvements to IPSASs* issued in January 2010. An entity shall apply the amendments in paragraphs 10, 11, and 37 for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2011, it shall disclose that fact. An entity shall apply the amendments in**

paragraphs 113, 114, 131 and 131A to changes in benefits that occur on or after January 1, 2011.

177B. **Paragraphs 166, 167, 168, 169, 170, 171, 172, 173, 174, 175, 176 and 178 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

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

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 25.

Example Illustrating Paragraph 21: Accounting for a Performance-Related Bonus Plan

AG1. A performance-related bonus plan requires a government printing unit to pay a specified proportion of its surplus for the year to employees who meet predetermined performance targets and serve throughout the year, i.e., are in post on both the first and last day of the reporting period. If no employees leave during the year, the total bonus payments for the year will be 3% of actual surplus. The entity determines that staff turnover will reduce the payments to 2.5% of actual surplus.

The entity recognizes a liability and an expense of 2.5% of actual surplus.

Example Illustrating Paragraph 36: Accounting for a Multi-Employer Plan

AG2. Along with similar entities in State X, Local Government Unit A participates in a multi-employer defined benefit plan. Because the plan exposes the participating entities to actuarial risks associated with the current and former employees of other local government units participating in the plan, there is no consistent and reliable basis for allocating the obligation, plan assets, and cost to individual local government units participating in the plan. Local Government Unit A therefore accounts for the plan as if it were a defined contribution plan. A funding valuation, which is not drawn up on the basis of assumptions compatible with the requirements of this Standard, shows a deficit of 480 million currency units in the plan. The plan has agreed, under a binding arrangement, a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next five years. Local Government Unit A's total contributions under the contract are 40 million currency units.

The entity recognizes a liability for the contributions adjusted for the time value of money and an equal expense in surplus or deficit.

Example Illustrating Paragraph 73: Limits on Recognition of Plan Asset

AG3. A defined benefit plan has the following characteristics:

Present value of the obligation	1100
Fair value of plan assets	(1190)
	(90)
Unrecognized actuarial losses	(110)
Unrecognized past service cost	(70)
Negative amount determined under paragraph 65	(270)
Present value of available future refunds and reductions in future contributions	60
The limit under paragraph 69(b) is computed as follows:	
Unrecognized actuarial losses	*110*
Unrecognized past service cost	*70*
Present value of available future refunds and reductions in future contributions	*60*
Limit	*240*

240 is less than 270. Therefore, the entity recognizes an asset of 240 and discloses that the limit in paragraph 69(b) reduced the carrying amount of the asset by 30 (see paragraph 141(f)(iii)).

Example Illustrating Paragraph 78: Projected Unit Credit Method

AG4. A lump sum benefit is payable on termination of service and equal to 1% of final salary for each year of service. The salary in year 1 is 10,000 and is assumed to increase at 7% (compound) each year. The discount rate used is 10% per annum. The following table shows how the obligation builds up for an employee who is expected to leave at the end of year five, assuming that there are no changes in actuarial assumptions. For simplicity, this example ignores the additional adjustment needed to reflect the probability that the employee may leave the entity at an earlier or later date.

Year	*1*	*2*	*3*	*4*	*5*
Benefit attributed to:					
– *prior years*	*0*	*131*	*262*	*393*	*524*
– *current year (1% of final salary)*	*131*	*131*	*131*	*131*	*131*
– *current and prior years*	*131*	*262*	*393*	*524*	*655*
Year	***1***	***2***	***3***	***4***	***5***
Opening obligation	–	*89*	*196*	*324*	*476*
Interest at 10%	–	*9*	*20*	*33*	*48*
Current service cost	*89*	*98*	*108*	*119*	*131*
Closing obligation	*89*	*196*	*324*	*476*	*655*

Note:

1. *The opening obligation is the present value of benefit attributed to prior years.*
2. *The current service cost is the present value of benefit attributed to the current year.*
3. *The closing obligation is the present value of benefit attributed to current and prior years.*

Examples Illustrating Paragraph 81: Attributing Benefit to Years of Service

AG5. A defined benefit plan provides a lump sum benefit of 100 payable on retirement for each year of service.

A benefit of 100 is attributed to each year. The current service cost is the present value of 100. The present value of the defined benefit obligation is the present value of 100, multiplied by the number of years of service up to the reporting date.

If the benefit is payable immediately when the employee leaves the entity, the current service cost and the present value of the defined benefit obligation reflect the date at which the employee is expected to leave. Thus, because of the effect of discounting, they are less than the amounts that would be determined if the employee left at the reporting date.

AG6. A plan provides a monthly pension of 0.2% of final salary for each year of service. The pension is payable from the age of 65.

Benefit equal to the present value, at the expected retirement date, of a monthly pension of 0.2% of the estimated final salary payable from the expected retirement date until the expected date of death is attributed to each year of service. The current service cost is the present value of that benefit. The present value of the defined benefit obligation is the present value of monthly pension payments of 0.2% of final salary, multiplied by the number of years of service up to the reporting date. The current service cost *and the present value of the defined benefit obligation are discounted, because pension payments begin at the age of 65.*

Examples Illustrating Paragraph 82: Vesting and Non-Vesting Benefits

AG7. A plan pays a benefit of 100 for each year of service. The benefits vest after 10 years of service.

A benefit of 100 is attributed to each year. In each of the first 10 years, the current service cost and the present value of the obligation reflect the probability that the employee may not complete ten years of service.

AG8. A plan pays a benefit of 100 for each year of service, excluding service before the age of 25. The benefits vest immediately.

No benefit is attributed to service before the age of 25, because service before that date does not lead to benefits (conditional or unconditional). A benefit of 100 is attributed to each subsequent year.

Examples Illustrating Paragraph 83: Attributing Benefits to Accounting Periods

AG9. A plan pays a lump sum benefit of 1,000 that vests after 10 years of service. The plan provides no further benefit for subsequent service.

A benefit of 100 (1,000 divided by 10) is attributed to each of the first 10 years. The current service cost in each of the first 10 years reflects the probability that the employee may not complete 10 years of service. No benefit is attributed to subsequent years.

AG10. A plan pays a lump sum retirement benefit of 2,000 to all employees who are still employed at the age of 55 after 20 years of service, or who are still employed at the age of 65, regardless of their length of service.

For employees who join before the age of 35, service first leads to benefits under the plan at the age of 35 (an employee could leave at the age of 30 and return at the age of 33, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 55 will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (2,000 divided by 20) to each year from the age of 35 to the age of 55.

For employees who join between the ages of 35 and 45, service beyond twenty years will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (2,000 divided by 20) to each of the first twenty years.

For an employee who joins at the age of 55, service beyond ten years will lead to no material amount of further benefits. For this employee, the entity attributes benefit of 200 (2,000 divided by 10) to each of the first 10 years.

For all employees, the current service cost and the present value of the obligation reflect the probability that the employee may not complete the necessary period of service.

AG11. A post-employment medical plan reimburses 40% of an employee's post-employment medical costs if the employee leaves after more than 10 and less than 20 years of service, and 50% of those costs if the employee leaves after 20 or more years of service.

Under the plan's benefit formula, the entity attributes 4% of the present value of the expected medical costs (40% divided by 10) to each of the first ten years and 1% (10% divided by 10) to each of the second 10 years. The current service cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefits. For employees expected to leave within 10 years, no benefit is attributed.

AG12. A post-employment medical plan reimburses 10% of an employee's post-employment medical costs if the employee leaves after more than 10 and less than 20 years of service, and 50% of those costs if the employee leaves after 20 or more years of service.

Service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after 20 or more years, the entity attributes benefit on a straight-line basis under paragraph 68. Service beyond 20 years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first 20 years is 2.5% of the present value of the expected medical costs (50% divided by 20).

For employees expected to leave between 10 and 20 years, the benefit attributed to each of the first 10 years is 1% of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.

For employees expected to leave within 10 years, no benefit is attributed.

Example Illustrating Paragraph 84: Attributing Benefits to Accounting Periods

AG13. Employees are entitled to a benefit of 3% of final salary for each year of service before the age of 55.

Benefit of 3% of estimated final salary is attributed to each year up to the age of 55. This is the date when further service by the employee will lead to no material amount of further benefits under the plan. No benefit is attributed to service after that age.

Example Illustrating Paragraph 113: Accounting for Past Service Cost

AG14. An entity operates a pension plan that provides a pension of 2% of final salary for each year of service. The benefits become vested after five years of service. On January 1, 20X9, the entity improves the pension to 2.5% of final salary for each year of service starting from January 1, 20X5. At the date of the improvement, the present value of the additional benefits for service from January 1, 20X5 to January 1, 20X9 is as follows:

Employees with more than five years service at 1/1/X9	150
Employees with less than five years service at 1/1/X9 (average period until vesting: three years)	120
	270

The entity recognizes 150 immediately because those benefits are already vested. The entity recognizes 120 on a straight-line basis over three years from January 1, 20X9.

Example Illustrating Paragraphs 121–123: Reimbursements

AG15. Reimbursements:

Present value of obligation	1,241
Unrecognized actuarial gains	17
Liability recognized in statement of financial position	1,258
Rights from insurance policies that exactly match the amount and timing of some of the benefits payable under the plan. Those benefits have a present value of 1,092.	1,092

The unrecognized actuarial gains of 17 are the net cumulative actuarial gains on the obligation and on the reimbursement rights.

Example Illustrating Paragraph 125–127: Return on Plan Assets

AG16. At January 1, 20X7, the fair value of plan assets was 10,000, and net cumulative unrecognized actuarial gains were 760. On June 30, 20X7, the plan paid benefits of 1,900 and received contributions of 4,900. At December 31, 20X7, the fair value of plan assets was 15,000, and the present value of the defined benefit obligation was 14,792. Actuarial losses on the obligation for 20X7 were 60.

At January 1, 20X7, the reporting entity made the following estimates, based on market prices at that date:

	%
Interest and dividend income, after tax payable by the fund	9.25
Realized and unrealized gains on plan assets (after tax)	2.00
Administration costs	(1.00)
Expected rate of return	10.25

For 20X7, the expected and actual return on plan assets are as follows:

Return on 10,000 held for 12 months at 10.25%	1,025
Return on 3,000 held for six months at 5% (equivalent to 10.25% annually, compounded every six months)	150
Expected return on plan assets for 20X7	1,175
Fair value of plan assets at December 31, 20X7	15,000
Less fair value of plan assets at January 1, 20X7	(10,000)
Less contributions received	(4,900)
Add benefits paid	1,900
Actual return on plan assets	2,000

The difference between the expected return on plan assets (1,175) and the actual return on plan assets (2,000) is an actuarial gain of 825. Therefore, the cumulative net unrecognized actuarial gains are 1,525 (760 plus 825 minus 60). Under paragraph 105, the limits of the corridor are set at 1,500 (greater of: (i) 10% of 15,000 and (ii) 10% of 14,792). In the following year (20X8), the entity recognizes in surplus or deficit an actuarial gain of 25 (1,525 minus 1,500) divided by the expected average remaining working life of the employees concerned.

The expected return on plan assets for 20X8 will be based on market expectations at January 1 20X8 for returns over the entire life of the obligation.

Example Illustrating Paragraph 135: Accounting for a Curtailment Without a Settlement

AG17. An entity is required by legislation to discontinue the direct provision of waste collection and waste disposal services. Employees of this discontinued segment will earn no further benefits. This is a curtailment without a settlement. Using current actuarial assumptions (including current market interest rates and other current market prices) immediately before the curtailment, the entity has a defined benefit obligation with a net present value of 1,000, plan assets with a fair value of 820, and net cumulative unrecognized actuarial gains of 50. The curtailment reduces the net present value of the obligation by 100 to 900.

Of the previously unrecognized actuarial gains, 10% (100/1,000) relates to the part of the obligation that was eliminated through the curtailment. Therefore, the effect of the curtailment is as follows:

	Before curtailment	*Curtailment gain*	*After curtailment*
Net present value of obligation	*1000*	*(100)*	*900*
Fair value of plan assets	*(820)*	*–*	*(820)*
	180	*(100)*	*80*
Unrecognized actuarial gains	*50*	*(5)*	*45*
Net liability recognized in statement of financial position	*230*	*(105)*	*125*

Example Illustrating Paragraphs 166 to 168: Determining the Initial Liability

AG18. At December 31 2010, an entity's statement of financial position includes a pension liability of 100. The entity adopts this Standard as of January 1 2011, when the present value of the obligation under the Standard is 1,300 and the fair value of plan assets is 1,000. On January 1 2005, the entity had improved pensions (cost for non-vested benefits: 160; and average remaining period at that date until vesting: 10 years).

The initial effect is as follows:

Present value of the obligation	*1,300*
Fair value of plan assets	*(1,000)*
Minus: past service cost to be recognized in later periods (160 × 4/10)	*(64)*
Initial liability	*236*
Liability already recognized under previous policy	*100*
Additional liability	*136*

The entity recognizes the additional liability of 136 in opening accumulated surpluses or deficits

Basis for Conclusions

This Basis for Conclusions accompanies, but does not form part of, IPSAS 25.

Development of IPSAS 25 based on the IASB's revised version of IAS 19 issued in 2004

Introduction

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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. The labor-intensive character of the operations of very many public sector entities means that expenses and liabilities related to employee benefits are likely to be particularly significant in evaluating the financial performance and financial position of those entities. It is therefore essential that the general purpose financial statements of public sector entities report expenses and liabilities related to employee benefits, and that these should be determined on a systematic and consistent basis. It is also important that relevant disclosures are provided to users.

BC3. Development of a standard on employee benefits has previously been deferred for two reasons. First, the IPSASB decided to prioritize resources on public sector-specific projects, including projects on social benefits provided by public sector entities in non-exchange transactions and revenue from non-exchange transactions. Second, in the earlier part of this decade it appeared possible that there might have been very significant changes to IAS 19. The IPSASB notes that the IASB currently has a project on postretirement benefits under way. The project is being conducted in two phases, which involve a fundamental review of all aspects of post-employment benefit accounting. Phase One is part of the short-term convergence project of the IASB and the Financial Accounting Standards Board. While this project may identify issues that can be resolved relatively quickly, the IPSASB considers that the development of proposals for fundamental changes to accounting for post-employment benefits is not sufficiently advanced to justify deferral of this Standard. The IPSASB will continue to monitor developments in the IASB's project.

Composite Social Security Programs and State Plans

BC4. In many jurisdictions, post-employment benefits are paid through composite social security programs. Composite social security programs also provide benefits that are not consideration in exchange for service rendered by employees or past employees. The IPSASB concluded that, because they are particularly significant in some jurisdictions, including a number of European countries, composite social security programs should be defined and requirements provided for their treatment. This Standard includes in paragraph 10 a definition of composite social security programs that encompasses both components of such programs.

BC5. This Standard does not deal with all potential obligations of public sector entities under composite social security programs. As this Standard deals with employee benefits of reporting entities, only benefits payable under composite social security programs as consideration in exchange for service rendered by employees of the reporting entity are within its scope. The IPSASB is addressing certain other benefits payable under composite social security schemes in a separate project dealing with social benefits.

BC6. This Standard retains the requirement in IAS 19 that an entity accounts for a state plan in the same way as for a multi-employer plan. The IPSASB concluded that it should provide further commentary to clarify the approach to accounting for state plans by public sector entities. Paragraph 46 provides a rebuttable presumption that the state plan will be characterized as a defined benefit plan by the controlling entity. Only where that presumption is rebutted is the state plan accounted for as a defined contribution plan.

Defined Benefit Plans with Participating Entities under Common Control

BC7. In the public sector, there are likely to be many cases where entities under common control participate in defined benefit plans. IAS 19 includes commentary on defined benefit plans that share risks between entities under common control. The IPSASB considered that the requirements in IAS 19 are appropriate in the public sector. The IPSASB also considered it appropriate to emphasize that, unless there is a contractual agreement, binding arrangement, or stated policy for charging the net defined benefit cost for the plan as a whole to an individual entity, it is inappropriate for controlled entities to account on a defined benefit basis. In such cases, the controlling entity should account for such plans on a defined benefit basis in its consolidated financial statements. Controlled entities (a) account on a defined contribution basis, (b) identify the controlling entity, and (c) disclose that the controlling entity is accounting on a defined benefit basis in its consolidated financial statements. This is reflected in paragraph 41. Controlled entities also make the disclosures specified in paragraph 42.

Discount Rates

BC8. IAS 19 requires adoption of a discount rate based on the market yields at the reporting date on high quality corporate bonds. The IPSASB decided that the discount rate should reflect the time value of money, and considered that entities should be left to determine the rate that best achieves that objective. The IPSASB considered that the time value of money may be best reflected by reference to market yields on government bonds, high quality corporate bonds, or any other financial instrument. The discount rate used is not intended to incorporate the risk associated with defined benefit obligations or entity-specific credit risk. There is an additional disclosure requirement at paragraph 141(n)(ii) informing users of the basis on which the discount rate has been determined.

BC9. The IPSASB considered whether it should provide guidance to assist entities operating in jurisdictions where there is neither a deep market in government bonds nor a deep market in high quality corporate bonds to determine a discount rate that reflects the time value of money. The IPSASB acknowledges that determination of an appropriate discount rate is likely to be a difficult issue for entities operating in such jurisdictions, and that such entities may be in the process of migrating, or have recently migrated, to the accrual basis of accounting. However, the IPSASB concluded that this is not an issue that applies only in the public sector, and that there is an insufficiently clear public sector-specific reason to provide such guidance.

Actuarial Gains and Losses—the Corridor

BC10. The IPSASB considered accounting requirements for actuarial gains and losses. In particular, the IPSASB considered whether the approach in IAS 19 known as the corridor, whereby actuarial gains and losses only have to be recognized immediately if they fall outside predetermined parameters, related to the fair value of plan assets and the carrying amount of defined benefit obligations at the last reporting date, should be adopted in this Standard. The IPSASB recognized the view of those who argue that that the corridor approach is conceptually unsound and leads to an unjustifiable deferral of revenue and expenses. However, the IPSASB concluded that there is no public sector-specific reason to remove the corridor provisions and require the immediate recognition of all actuarial gains and losses. The IPSASB therefore decided to retain the corridor approach in this Standard, and to allow entities to select any of the three options permitted by IAS 19 for dealing with actuarial gains and losses that are within the "corridor." These are:

(a) Non-recognition;

(b) Recognition on a systematic and consistent basis of actuarial gains and losses related to all defined benefit plans in the statement of financial performance; and

(c) Recognition on a systematic and consistent basis of actuarial gains and losses related to all defined benefit plans outside the statement of financial performance.

Actuarial Gains and Losses: Presentation where Recognition is Outside the Statement of Financial Performance

BC11. When the IPSASB developed ED 31, *Employee Benefits*, IAS 19 (2004) and IAS 1 required "the statement of changes in equity" to be re-termed "the statement of recognized income and expense," where an entity adopted a policy of recognizing actuarial gains and losses for all its defined benefit plans outside the income statement. The suite of financial statements in IPSAS 1, *Presentation of Financial Statements*, does not include a "statement of recognized revenue and expense." The IPSASB therefore considered whether IPSAS 1 should be amended to re-term the "statement of changes in net assets/equity" the "statement of recognized revenue and expense" under certain circumstances, or whether entities should be permitted to recognize actuarial gains and losses in the existing "statement of changes in net assets/equity," which is required by IPSAS 1. The IPSASB initially concluded that, consistent with its objective of promoting convergence with IFRSs, it should effect a consequential amendment to IPSAS 1 to re-term "the statement of net assets/equity" as the "statement of recognized revenue and expense" when it only includes certain line items, including actuarial gains and losses. This approach was generally supported at consultation.

BC12. The IASB has subsequently issued a revised IAS 1 that includes a consequential amendment to IAS 19. This deletes references to the statement of recognized income and expense, and requires actuarial gains and losses recognized outside profit or loss to be presented as a component of other comprehensive income. The IPSASB has not yet considered the revised IAS 1. Rather than adopt a treatment that aims to converge with an approach in IFRSs that has already been superseded, the IPSASB decided to adopt a requirement that, where actuarial gains and losses are recognized outside the statement of financial performance, they should be presented in the statement of changes in net assets/equity.

Reimbursements

BC13. Although the requirement in relation to reimbursements in IAS 19 is general, the commentary is written from the perspective of insurance policies that are not qualifying insurance policies, and are therefore not plan assets. The IPSASB considered whether there may be cases in the public sector where another public sector entity may enter into a legally binding commitment to provide part or all of the expenditure required to settle a defined benefit obligation of the reporting entity. The IPSASB considered that there may be such circumstances. ED 31 therefore included expanded commentary to acknowledge that such circumstances may arise. Some submissions considered that this revised commentary was confusing. Acknowledging this view the IPSASB decided to use the same commentary as in IAS 19, and to put the onus on entities to determine whether they have an asset arising from a right to reimbursement by reference to the definition of an asset in the IPSASB literature.

Other Long-Term Employee Benefits: Long-Term Disability Benefits

BC14. IAS 19 lists long-term disability benefits as an example of an "other long-term employee benefit." IAS 19 states that "the measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of post-employment benefits," and that "the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost." In the public sector, disability benefits related to certain areas of service provision, such as the military, may be financially highly significant, and related actuarial gains or losses volatile.

BC15. IPSAS 25 therefore provides a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Where this presumption is rebutted, the entity considers whether some or all long-term disability payments should be accounted for using the same requirements as for post-employment benefits.

Other Long-Term Employee Benefits: Compensation Payable by the Reporting Entity until an Individual Enters New Employment

BC16. Although it does not consider it likely that such circumstances are widespread, the IPSASB acknowledged that there may be cases where a reporting entity is contractually bound to make compensation payments separate from a termination benefit to a past employee until he/she enters new employment. The list of other long-term benefits in paragraph 147 was therefore amended to include such circumstances.

Implementation Arrangements

BC17. The IPSASB acknowledged that applying the requirements of this Standard in relation to liabilities relating to obligations arising from defined benefit plans may prove challenging for many public sector entities. Currently, many public sector entities may not be recognizing liabilities related to such obligations, and may therefore not have the systems in place to provide the information required for reporting under the requirements of this Standard. Where entities are recognizing liabilities relating to obligations arising from defined benefit plans, this may be on a different basis to that required by this Standard. In some cases, adoption of this Standard might give rise to tensions with budgetary projections and other prospective information.

BC18. IAS 19 requires entities adopting that Standard to determine a transitional liability. Where the amount of the transitional liability is more than the liability that would have been recognized at the same date under the previous accounting policy, IAS 19 permits entities to expense that difference on a straight-line basis over a period up to five years from the date of adoption.

BC19. The impact on financial performance and financial position of increases in liabilities arising from adoption of this Standard will be an issue for many public sector entities. However, as indicated in paragraph BC17, a more immediate issue may be obtaining the information in the first place. The IPSASB therefore concluded that, in order to give public sector entities the time to develop new systems and upgrade existing systems, this Standard should become effective for reporting periods commencing on or after January 1, 2011. Consistent with this objective, in the first year of adoption comparative information is not required. Earlier adoption is encouraged.

BC20. In paragraph 166, this Standard requires entities to determine an initial liability for defined benefit plans. Because entities do not have to adopt the Standard until reporting periods commencing on or after January 1 2011, the IPSASB concluded that it is not necessary to introduce a transitional provision permitting entities to expense over a period any difference between the initial liability and the liability that would have been recognized under the previous accounting policy. In order to avoid a potential distortion of financial performance in the first year of adoption, and, for consistency with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, this Standard requires the difference between the initial liability and the liability that would have been recognized at the same date under the previous accounting policy to be taken to opening accumulated surpluses or deficits.

BC21. The IPSASB also considered whether, in the light of possible difficulties for reporting entities in assembling information, it would be appropriate to provide relief from certain disclosure requirements in paragraph 141 of this Standard. These disclosures require opening balances relating to a number of components of obligations and plan assets or trend information covering the current reporting period and previous four reporting periods. The IPSASB concluded that, because some entities may require the full lead-in period to develop systems, such relief is appropriate. It is therefore included in the Standard in paragraphs 173 and 175.

Revision of IPSAS 25 as a result of the IASB's Improvements to IFRSs issued in 2008

BC22. The IPSASB reviewed the revisions to IAS 19 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendments.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 25.

Funded Defined Benefit Plan

Extracts from statements of financial performance and statements of financial position are provided to show the effects of the transactions described below. These extracts do not necessarily conform with all the disclosure and presentation requirements of other Standards.

Background Information

IE1. The following information is given about a funded defined benefit plan. To keep interest computations simple, all transactions are assumed to occur at the year end. The present value of the obligation and the fair value of the plan assets were both 1,000 at January 1, 20X7. Net cumulative unrecognized actuarial gains at that date were 140.

	20X7	**20X8**	**20X9**
Discount rate at start of year	10.0%	9.0%	8.0%
Expected rate of return on plan assets at start of year	12.0%	11.1%	10.3%
Current service cost	130	140	150
Benefits paid	150	180	190
Contributions paid	90	100	110
Present value of obligation at December 31	1,141	1,197	1,295
Fair value of plan assets at December 31	1,092	1,109	1,093
Expected average remaining working lives of employees (years)	10	10	10

IE2. In 20X8, the plan was amended to provide additional benefits with effect from January 1, 20X8. The present value as at January 1, 20X8 of additional benefits for employee service before January 1, 20X8 was 50 for vested benefits and 30 for non-vested benefits. As at January 1, 20X8, the entity estimated that the average period until the non-vested benefits would become vested was three years; the past service cost arising from additional non-vested benefits is therefore recognized on a straight-line basis over three years. The past service cost arising from additional vested benefits is recognized immediately (paragraph 112 of the Standard). The entity has adopted a policy of recognizing actuarial gains and losses under the minimum requirements of paragraph 106.

Changes in the Present Value of the Obligation and in the Fair Value of the Plan Assets

IE3. The first step is to summarize the changes in the present value of the obligation and in the fair value of the plan assets and use this to determine the amount of the actuarial gains or losses for the period. These are as follows:

	20X7	**20X8**	**20X9**
Present value of obligation, January1	1,000	1,141	1,197
Interest cost	100	103	96
Current service cost	130	140	150
Past service cost – non-vested benefits	–	30	–
Past service cost – vested benefits	–	50	–
Benefits paid	(150)	(180)	(190)
Actuarial (gain) loss on obligation (balancing figure)	61	(87)	42
Present value of obligation, December 31	1,141	1,197	1,295
Fair value of plan assets, January 1	1,000	1,092	1,109
Expected return on plan assets	120	121	114
Contributions	90	100	110
Benefits paid	(150)	(180)	(190)
Actuarial gain (loss) on plan assets (balancing figure)	32	(24)	(50)
Fair value of plan assets, December 31	1,092	1,109	1,093

Limits of the Corridor

IE4. The next step is to determine the limits of the corridor, and then compare these with the cumulative unrecognized actuarial gains and losses in order to determine the net actuarial gain or loss to be recognized in the following period. Under paragraph 105 of this Standard, the limits of the corridor are set at the greater of:

(a) 10% of the present value of the obligation before deducting plan assets; and

(b) 10% of the fair value of any plan assets.

IE5. These limits, and the recognized and unrecognized actuarial gains and losses, are as follows:

	20X7	20X8	20X9
Net cumulative unrecognized actuarial gains (losses) at January1	140	107	170
Limits of corridor at January 1	100	114	120
Excess [A]	40	–	50
Average expected remaining working lives (years) [B]	10	10	10
Actuarial gain (loss) to be recognized [A/B]	4	–	5
Unrecognized actuarial gains (losses) at January 1	140	107	170
Actuarial gain (loss) for year – obligation	(61)	87	(42)
Actuarial gain (loss) for year – plan assets	32	(24)	(50)
Subtotal	111	170	78
Actuarial (gain) loss recognized	(4)	–	(5)
Unrecognized actuarial gains (losses) at December 31	107	170	73

Amounts Recognized in the Statement of Financial Position and Statement of Financial Performance, and Related Analyses

IE6. The final step is to determine the amounts to be recognized in the statement of financial position and the statement of financial performance, and the related analyses to be disclosed in accordance with paragraph 141(f), (g), and (m) of the Standard (the analyses required to be disclosed in accordance with paragraph 141(c) and (e) are given in the section of this Illustrative Example, "Changes in the Present Value of the Obligation and in the Fair Value of the Plan Assets." These are as follows.

	20X7	20X8	20X9
Present value of the obligation	1,141	1,197	1,295
Fair value of plan assets	(1,092)	(1,109)	(1,093)
	49	88	202
Unrecognized actuarial gains (losses)	107	170	73
Unrecognized past service cost – non-vested benefits	–	(20)	(10)
Liability recognized in statement of financial position	**156**	**238**	**265**
Current service cost	130	140	150
Interest cost	100	103	96
Expected return on plan assets	(120)	(121)	(114)
Net actuarial (gain) loss recognized in year	(4)	–	(5)
Past service cost – non-vested benefits	–	10	10
Past service cost – vested benefits	–	50	–
Expense recognized in statement of financial performance	**106**	**182**	**137**
Actual return on plan assets			
Expected return on plan assets	120	121	114
Actuarial gain (loss) on plan assets	32	(24)	(50)
Actual return on plan assets	152	97	64

Note: see example illustrating paragraphs 121–123 for presentation of reimbursements.

Disclosures

Extracts from notes show how the required disclosures may be aggregated in the case of an entity that provides a variety of employee benefits. These extracts do not necessarily conform with all the disclosure and presentation requirements of IPSAS 25 and other standards. In particular, they do not illustrate the disclosure of:

(a) *Accounting policies for employee benefits (see IPSAS 1, Presentation of Financial Statements.) Paragraph 141(a) of this Standard requires this disclosure to include the entity's accounting policy for recognizing actuarial gains and losses;*

(b) *A general description of the type of plan (paragraph 141(b));*

(c) *A narrative description of the basis used to determine the overall expected rate of return on assets (paragraph 141(l)).*

(d) *Employee benefits granted to key management personnel (see IPSAS 20, Related Party Disclosures); or*

(e) *Share-based employee benefits (see the international or national accounting standard dealing with share-based payments).*

IE7. Illustrative disclosures are as follows.

Employee Benefit Obligations

The amounts recognized in the statement of financial position are as follows:

	Defined benefit pension plans		**Post-employment medical benefits**	
	20X8	**20X7**	**20X8**	**20X7**
Present value of funded obligations	20,300	17,400	–	–
Fair value of plan assets	(18,420)	(17,280)	–	–
	1,880	120	–	–
Present value of unfunded obligations	2,000	1,000	7,337	6,405
Unrecognized actuarial gains (losses)	(1,605)	840	(2,707)	(2,607)
Unrecognized past service cost	(450)	(650)	–	–
Net liability	1,825	1,310	4,630	3,798
Amounts in the statement of financial position:				
liabilities	1,825	1,400	4,630	3,798
assets	–	(90)	–	–
Net liability	1,825	1,310	4,630	3,798

The pension plan assets include ordinary shares issued by [name of reporting entity] with a fair value of 317 (20X7: 281). Plan assets also include property occupied by [name of reporting entity] with a fair value of 200 (20X7: 185).

The amounts recognized in surplus or deficit are as follows:

	Defined benefit pension plans		**Post-employment medical benefits**	
	20X8	**20X7**	**20X8**	**20X7**
Current service cost	850	750	479	411
Interest on obligation	950	1,000	803	705
Expected return on plan assets	(900)	(650)		
Net actuarial losses (gains) recognized in year	(70)	(20)	150	140
Past service cost	200	200		
Losses (gains) on curtailments and settlements	175	(390)		
Total, included in employee benefits expense	1,205	890	1,432	1,256
Actual return on plan assets	600	2,250	–	–

Changes in the present value of the defined benefit obligation are as follows:

	Defined benefit pension plans		Post-employment medical benefits	
	20X8	**20X7**	**20X8**	**20X7**
Opening defined benefit obligation	18,400	11,600	6,405	5,439
Service cost	850	750	479	411
Interest cost	950	1,000	803	705
Actuarial losses (gains)	2,350	950	250	400
Losses (gains) on curtailments	(500)	–		
Liabilities extinguished on settlements	–	(350)		
Liabilities assumed in an entity combination	–	5,000		
Exchange differences on foreign plans	900	(150)		
Benefits paid	(650)	(400)	(600)	(550)
Closing defined benefit obligation	22,300	18,400	7,337	6,405

Changes in the fair value of plan assets are as follows:

	Defined benefit pension plans	
	20X8	**20X7**
Opening fair value of plan assets	17,280	9,200
Expected return	900	650
Actuarial gains (losses)	(300)	1,600
Assets distributed on settlements	(400)	–
Contributions by employer	700	350
Assets acquired in an entity combination	–	6,000
Exchange differences on foreign plans	890	(120)
Benefits paid	(650)	(400)
	18,420	17,280

The entity expects to contribute 900 to its defined benefit pension plans in 20X9.

The major categories of plan assets as a percentage of total plan assets are as follows:

	20X8	**20X7**
European equities	30%	35%
North American equities	16%	15%
European bonds	31%	28%
North American bonds	18%	17%
Property	5%	5%

Principal actuarial assumptions at the reporting date (expressed as weighted averages):

	20X8	20X7
Discount rate at December 31	5%	6.5%
Expected return on plan assets at December 31	5.4%	7%
Future salary increases	5%	4%
Future pension increases	3%	2%
Proportion of employees opting for early retirement	30%	30%
Annual increase in healthcare costs	8%	8%
Future changes in maximum state healthcare benefits	3%	2%

Assumed healthcare cost trend rates have a significant effect on the amounts recognized in surplus or deficit. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	One percentage point increase	**One percentage point decrease**
Effect on the aggregate of the service cost and interest cost	190	(150)
Effect on defined benefit obligation	1,000	(900)

Amounts for the current and previous four periods are as follows:

Defined benefit pension plans

	20X8	**20X7**	**20X6**	**20X5**	**20X4**
Defined benefit obligation	(22,300)	(18,400)	(11,600)	(10,582)	(9,144)
Plan assets	18,420	17,280	9,200	8,502	10,000
Surplus (deficit)	(3,880)	(1,120)	(2,400)	(2,080)	856
Experience adjustments on plan liabilities	(1,111)	(768)	(69)	543	(642)
Experience adjustments on plan assets	(300)	1,600	(1,078)	(2,890)	2,777

Post-employment medical benefits

	20X8	**20X7**	**20X6**	**20X5**	**20X4**
Defined benefit obligation	7,337	6,405	5,439	4,923	4,221
Experience adjustments on plan liabilities	(232)	829	490	(174)	(103)

The reporting entity also participates in a defined benefit plan for all local government units in Jurisdiction Y that provides pensions linked to final salaries and is funded on a pay-as-you-go basis. It is not practicable to determine the present value of the economic entity's obligation or the related current service cost, as the plan computes its obligations on a basis that differs materially from the basis used in [name of reporting entity]'s financial statements. [describe basis] On that basis, the plan's financial statements to June 30 20X6 show an unfunded liability of 27,525. The unfunded liability will result in future payments by participating employers. The plan has approximately 75,000 members, of whom approximately 5,000 are current or former employees of [name of reporting entity] or their dependants. The expense recognized in the statement of financial performance, which is equal to contributions due for the year, and is not included in the above amounts, was 230 (20X7: 215). The reporting entity's future contributions may be increased substantially if other entities withdraw from the plan.

Illustration of the Application of Paragraph 70

The Issue

IE8. Paragraph 69 of this Standard imposes a ceiling on the defined benefit asset that can be recognized.

> 69. **The amount determined under paragraph 65 may be negative (an asset). An entity shall measure the resulting asset at the lower of:**
>
> (a) **The amount determined under paragraph 65** [i.e., the surplus/deficit in the plan plus (minus) any unrecognized losses (gains)]**; and**
>
> (b) **The total of:**
>
> (i) **Any cumulative unrecognized net actuarial losses and past service cost (see paragraphs 105, 106 and 112); and**
>
> (ii) **The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits shall be determined using the discount rate specified in paragraph 91.**

IE9. Without paragraph 70 (see below), paragraph 69(b)(i) has the following consequence: sometimes deferring the recognition of an actuarial loss (gain) in determining the amount specified by paragraph 65 leads to a gain (loss) being recognized in the statement of financial performance.

IE10. The following example illustrates the effect of applying paragraph 69 without paragraph 70. The example assumes that the entity's accounting policy is not to recognize actuarial gains and losses within the corridor, and to amortize actuarial gains and losses outside the corridor. (Whether the corridor is used is not significant. The issue can arise whenever there is deferred recognition under paragraph 65.)

Example 1—Effect of applying paragraph 69 without paragraph 70

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses un-recognized under paragraph 65	Paragrap h 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	100	0	0	100	0	0	–
2	70	0	30	100	30	30	30

IE11. At the end of year 1, there is a surplus of 100 in the plan (column A in the table above), but no economic benefits are available to the entity either from refunds or reductions in future contributions* (column B). There are no unrecognized gains and losses under paragraph 65 (column C). So, if there were no asset ceiling, an asset of 100 would be recognized, being the amount specified by paragraph 65 (column D). The asset ceiling in paragraph 69 restricts the asset to nil (column F).

IE12. In year 2, there is an actuarial loss in the plan of 30 that reduces the surplus from 100 to 70 (column A), the recognition of which is deferred under paragraph 65 (column C). So, if there were no asset ceiling, an asset of 100 (column D) would be recognized. The asset ceiling without paragraph 70 would be 30 (column E). An asset of 30 would be recognized (column F), giving rise to an increase in revenue (column G), even though all that has happened is that a surplus from which the entity cannot benefit has decreased.

IE13. A similarly counter-intuitive effect could arise with actuarial gains (to the extent that they reduce cumulative unrecognized actuarial losses).

Paragraph 70

IE14. Paragraph 70 prohibits the recognition of gains (losses) that arise solely from past service cost and actuarial losses (gains).

70. **The application of paragraph 69 shall not result in a gain being recognized solely as a result of an actuarial loss or past service cost in the current period, or in a loss being recognized solely as a result of an actuarial gain in the current period. The entity shall therefore recognize immediately under paragraph 65 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 69(b):**

* Based on the current terms of the plan.

(a) **Net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 69(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period shall be recognized immediately under paragraph 65.**

(b) **Net actuarial gains of the current period after the deduction of past service cost of the current period to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 69(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period shall be recognized immediately under paragraph 65.**

IE15. The following examples illustrate the result of applying paragraph 70. As above, it is assumed that the entity's accounting policy is not to recognize actuarial gains and losses within the corridor, and to amortize actuarial gains and losses outside the corridor. For the sake of simplicity, the periodic amortization of unrecognized gains and losses outside the corridor is ignored in the examples.

Example 1 continued—Adjustment when there are actuarial losses and no change in the economic benefits available

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses un-recognized under paragraph 65	Paragrap h 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	100	0	0	100	0	0	–
2	70	0	0	70	0	0	0

IE16. The facts are as in example 1 above. Applying paragraph 70, there is no change in the economic benefits available to the entity[*] so the entire actuarial loss of 30 is recognized immediately under paragraph 65 (column D). The asset ceiling remains at nil (column F) and no gain is recognized.

[*] The term "economic benefits available to the entity" is used to refer to those economic benefits that qualify for recognition under paragraph 69(b)(ii).

IE17 In effect, the actuarial loss of 30 is recognized immediately, but is offset by the reduction in the effect of the asset ceiling.

	Asset in Statement of Financial Position under paragraph 65 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(100)	0
Year 2	70	(70)	0
Gain (loss)	(30)	(30)	0

IE18. In the above example, there is no change in the present value of the economic benefits available to the entity. The application of paragraph 70 becomes more complex when there are changes in present value of the economic benefits available, as illustrated in the following examples.

Example 2—Adjustment when there are actuarial losses and a decrease in the economic benefits available

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses un-recognized under paragraph 65	Paragrap h 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	60	30	40	100	70	70	–
2	25	20	50	75	70	70	0

IE19. At the end of year 1, there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognized losses of 40 under paragraph 65 (column C). So, if there were no asset ceiling, an asset of 100 would be recognized (column D). The asset ceiling restricts the asset to 70 (column F).

IE20. In year 2, an actuarial loss of 35 in the plan reduces the surplus from 60 to 25 (column A). The economic benefits available to the entity fall by 10 from 30 to 20 (column B). Applying paragraph 70, the actuarial loss of 35 is analyzed as follows:

Actuarial loss equal to the reduction in economic benefits	10
Actuarial loss that exceeds the reduction in economic benefits	25

IE21. In accordance with paragraph 70, 25 of the actuarial loss is recognized immediately under paragraph 65* (column D). The reduction in economic benefits of 10 is included in the cumulative unrecognized losses that increase to 50 (column C). The asset ceiling, therefore, also remains at 70 (column E) and no gain is recognized.

IE22. In effect, an actuarial loss of 25 is recognized immediately, but is offset by the reduction in the effect of the asset ceiling.

	Asset in Statement of Financial Position under paragraph 65 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(30)	70
Year 2	75	(5)	70
Gain (loss)	(25)	25	0

Example 3—Adjustment when there are actuarial gains and a decrease in the economic benefits available to the entity

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses un-recognized under paragraph 65	Paragraph 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	60	30	40	100	70	70	–
2	110	25	40	150	65	65	(5)

IE23. At the end of year 1, there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognized losses of 40 under paragraph 65 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognized (column D). The asset ceiling restricts the asset to 70 (column F).

IE24. In year 2, an actuarial gain of 50 in the plan increases the surplus from 60 to 110 (column A). The economic benefits available to the entity decrease by 5

* The application of paragraph 70 allows the recognition of some actuarial gains and losses to be deferred under paragraph 65 and, hence, to be included in the calculation of the asset ceiling. For example, cumulative unrecognized actuarial losses that have built up while the amount specified by paragraph 69(b) is not lower than the amount specified by paragraph 65 will not be recognized immediately at the point that the amount specified by paragraph 69(b) becomes lower. Instead, their recognition will continue to be deferred in line with the entity's accounting policy. The cumulative unrecognized losses in this example are losses the recognition of which is deferred even though paragraph 70 applies.

(column B). Applying paragraph 70, there is no increase in economic benefits available to the entity. Therefore, the entire actuarial gain of 50 is recognized immediately under paragraph 65 (column D) and the cumulative unrecognized loss under paragraph 65 remains at 40 (column C). The asset ceiling decreases to 65 because of the reduction in economic benefits. That reduction is not an actuarial loss as defined by IPSAS 25 and therefore does not qualify for deferred recognition.

IE25. In effect, an actuarial gain of 50 is recognized immediately, but is (more than) offset by the increase in the effect of the asset ceiling.

	Asset in Statement of Financial Position under paragraph 65 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(30)	70
Year 2	150	(85)	65
Gain (loss)	50	(55)	(5)

IE26. In both examples 2 and 3, there is a reduction in economic benefits available to the entity. However, in example 2 no loss is recognized whereas, in example 3, a loss is recognized. This difference in treatment is consistent with the treatment of changes in the present value of economic benefits before application of paragraph 70. The purpose of paragraph 70 is solely to prevent gains (losses) being recognized because of past service cost or actuarial losses (gains). As far as is possible, all other consequences of deferred recognition and the asset ceiling are left unchanged.

Example 4—Adjustment in a period in which the asset ceiling ceases to have an effect

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses un-recognized under paragraph 65	Paragrap h 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	60	25	40	100	65	65	–
2	(50)	0	115	65	115	65	0

IE27. At the end of year 1, there is a surplus of 60 in the plan (column A) and economic benefits are available to the entity of 25 (column B). There are unrecognized losses of 40 under paragraph 65 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognized (column D). The asset ceiling restricts the asset to 65 (column F).

IE28. In year 2, an actuarial loss of 110 in the plan reduces the surplus from 60 to a deficit of 50 (column A). The economic benefits available to the entity decrease from 25 to 0 (column B). To apply paragraph 70, it is necessary to determine how much of the actuarial loss arises while the defined benefit asset is determined in accordance with paragraph 69(b). Once the surplus becomes a deficit, the amount determined by paragraph 65 is lower than the net total under paragraph 69(b). So, the actuarial loss that arises while the defined benefit asset is determined in accordance with paragraph 69(b) is the loss that reduces the surplus to nil, i.e., 60. The actuarial loss is, therefore, analyzed as follows:

Actuarial loss that arises while the defined benefit asset is measured under paragraph 69(b):

Actuarial loss that equals the reduction in economic benefits	25
Actuarial loss that exceeds the reduction in economic benefits	35
	60
Actuarial loss that arises while the defined benefit asset is measured under paragraph 65	50
Total actuarial loss	110

IE29. In accordance with paragraph 70, 35 of the actuarial loss is recognized immediately under paragraph 65 (column D); 75 (25 plus 50) of the actuarial loss is included in the cumulative unrecognized losses, which increase to 115 (column C). The amount determined under paragraph 65 becomes 65 (column D), and under paragraph 69(b) becomes 115 (column E). The recognized asset is the lower of the two, i.e., 65 (column F), and no gain or loss is recognized (column G).

IE30. In effect, an actuarial loss of 35 is recognized immediately, but is offset by the reduction in the effect of the asset ceiling.

	Asset in Statement of Financial Position under paragraph 65 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(35)	65
Year 2	65	0	65
Gain (loss)	(35)	35	0

Notes

1. In applying paragraph 70 in situations when there is an increase in the present value of the economic benefits available to the entity, it is important to remember that the present value of the economic benefits available cannot

exceed the surplus in the plan.*

2. In practice, benefit improvements often result in a past service cost and an increase in expected future contributions, due to increased current service costs of future years. The increase in expected future contributions may increase the economic benefits available to the entity in the form of anticipated reductions in those future contributions. The prohibition against recognizing a gain solely as a result of past service cost in the current period does not prevent the recognition of a gain because of an increase in economic benefits. Similarly, a change in actuarial assumptions that causes an actuarial loss may also increase expected future contributions and, hence, the economic benefits available to the entity in the form of anticipated reductions in future contributions. Again, the prohibition against recognizing a gain solely as a result of an actuarial loss in the current period does not prevent the recognition of a gain because of an increase in economic benefits.

* In the example illustrating paragraph 73 of IPSAS 25, the present value of available future refunds in contributions could not exceed the surplus in the plan of 90.

Comparison with IAS 19

IPSAS 25 is drawn primarily from IAS 19 (2004) and includes amendments made to IAS 19 as part of the *Improvements to IFRSs* issued in May 2008. The main differences between IPSAS 25 and IAS 19 are as follows:

- IPSAS 25 contains additional guidance on public sector bonus plans.
- For discounting post-employment obligations, IAS 19 requires entities to apply a discount rate based on yields on high quality corporate bonds consistent with the currency and estimated term of the post-employment benefit obligations. The requirement in IPSAS 25 is that entities apply a rate that reflects the time value of money. IPSAS 25 also contains a requirement that entities disclose the basis on which the discount rate has been determined.
- IPSAS 25 includes a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of post-employment benefits. Where this presumption is rebutted, the entity considers whether some or all long-term disability payments should be accounted for in the same way as for post-employment benefits. IAS 19 does not include such a rebuttable presumption.
- IPSAS 25 uses different terminology, in certain instances, from IAS 19. The most significant examples are the use of the terms “revenue,” and “statement of financial performance.” The equivalent terms in IAS 19 are “income,” and “income statement.”

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IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 36, *Impairment of Assets*, published by the International Accounting Standards Board (IASB). Extracts from IAS 36 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 26, *Impairment of Cash-Generating Assets* was issued in February 2008.

Since then, IPSAS 26 has been amended by the following IPSASs:

- IPSAS 37, *Joint Arrangements* (issued January 2015)
- IPSAS 35, *Consolidated Financial Statements* (issued January 2015)
- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- IPSAS 27, *Agriculture* (issued December 2009)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)
- IPSAS 31, *Intangible Assets* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 26

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
2	Amended	IPSAS 27 December 2009 IPSAS 29 January 2010 IPSAS 31 January 2010
8	Amended	IPSAS 27 December 2009 IPSAS 29 January 2010
9	Amended	IPSAS 29 January 2010
12	Amended	IPSAS 37 January 2015 IPSAS 35 January 2015
27	Amended	Improvements to IPSASs November 2010

Paragraph Affected	How Affected	Affected By
123	Amended	Improvements to IPSASs January 2010
126A	New	Improvements to IPSASs January 2010
126B	New	Improvements to IPSASs January 2010
126C	New	IPSAS 31 January 2010
126D	New	IPSAS 33 January 2015
126E	New	IPSAS 35 January 2015
127	Amended	IPSAS 33 January 2015

February 2008

IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS

CONTENTS

International Public Sector Accounting Standard 26, *Impairment of Cash-Generating Assets*, is set out in paragraphs 1–127. All the paragraphs have equal authority. IPSAS 26 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the procedures that an entity applies to determine whether a cash-generating asset is impaired, and to ensure that impairment losses are recognized. This Standard also specifies when an entity should reverse an impairment loss, and prescribes disclosures.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for the impairment of cash-generating assets, except for:**

    (a) **Inventories (see IPSAS 12, *Inventories*);**

    (b) **Assets arising from construction contracts (see IPSAS 11, *Construction Contracts*);**

    (c) **Financial assets that are within the scope of IPSAS 29, *Financial Instruments: Recognition and Measurement*;**

    (d) **Investment property that is measured at fair value (see IPSAS 16, *Investment Property*);**

    (e) **Cash-generating property, plant, and equipment that is measured at revalued amounts (see IPSAS 17, *Property, Plant, and Equipment*);**

    (f) **Deferred tax assets (see the relevant international or national accounting standard dealing with deferred tax assets);**

    (g) **Assets arising from employee benefits (see IPSAS 25, *Employee Benefits*);**

    (h) **Cash-generating intangible assets that are measured at revalued amounts (see IPSAS 31, *Intangible Assets*);**

    (i) **Goodwill;**

    (j) **Biological assets related to agricultural activity that are measured at fair value less costs to sell (see IPSAS 27, *Agriculture*);**

    (k) **Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts;**

    (l) **Non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value, less costs to sell, in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations; and**

(m) **Other cash-generating assets in respect of which accounting requirements for impairment are included in another Standard.**

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 IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

5. GBEs apply IAS 36, *Impairment of Assets*, and therefore are not subject to the provisions of this Standard. Public sector entities, other than GBEs, that hold non-cash-generating assets as defined in paragraph 13 apply IPSAS 21, *Impairment of Non-Cash-Generating Assets*, to such assets. Public sector entities, other than GBEs, that hold cash-generating assets apply the requirements of this Standard.

6. This Standard excludes cash-generating intangible assets that are regularly revalued to fair value from its scope. This Standard includes all other cash-generating intangible assets (for example, those that are carried at cost less any accumulated amortization) within its scope.

7. This Standard excludes goodwill from its scope. Entities apply the requirements of the relevant international or national accounting standards dealing with the impairment of goodwill, the allocation of goodwill to cash-generating units, and the testing for impairment of cash-generating units with goodwill.

8. This Standard does not apply to inventories and cash-generating assets arising from construction contracts, because existing standards applicable to these assets contain requirements for recognizing and measuring such assets. This Standard does not apply to deferred tax assets, assets related to employee benefits, or deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts. The impairment of such assets is addressed in the relevant international or national accounting standards. In addition, this Standard does not apply to (a) biological assets related to agricultural activity that are measured at fair value less costs to sell, and (b) non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value less costs to sell. IPSAS 27 dealing with biological assets related to agricultural activity, and the relevant international or national accounting standards dealing with non-current assets (or disposal groups) classified as held for sale, contain measurement requirements.

9. This Standard does not apply to any financial assets that are included in the scope of IPSAS 28, *Financial Instruments: Presentation*. Impairment of these assets is dealt with in IPSAS 29.

10. This Standard does not require the application of an impairment test to an investment property that is carried at fair value in accordance with IPSAS 16. Under the fair value model in IPSAS 16, an investment property is carried at fair value at the reporting date, and any impairment will be taken into account in the valuation.

11. This Standard does not require the application of an impairment test to cash-generating assets that are carried at revalued amounts under the revaluation model in IPSAS 17. Under the revaluation model in IPSAS 17, assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date, and any impairment will be taken into account in that valuation.

12. Investments in:

    (a) Controlled entities, as defined in IPSAS 35, *Consolidated Financial Statements*;

    (b) Associates, as defined in IPSAS 36, *Investments in Associates and Joint Ventures*; and

    (c) Joint arrangements, as defined in IPSAS 37, *Joint Arrangements*,

    are financial assets that are excluded from the scope of IPSAS 29. Where such investments are in the nature of cash-generating assets, they are dealt with under this Standard. Where these assets are in the nature of non-cash-generating assets, they are dealt with under IPSAS 21.

Definitions

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

    A <u>cash-generating unit</u> is the smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

    <u>Recoverable amount</u> is the higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use.

    <u>Value in use of a cash-generating asset</u> is the present value of the estimated future cash flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life.

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

Cash-Generating Assets

14. Cash-generating assets are assets held with the primary objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Holding an asset to generate a "commercial return" indicates that an entity intends to (a) generate positive cash inflows from the asset (or from the cash-generating unit of which the asset is a part), and (b) earn a commercial return that reflects the risk involved in holding the asset. An asset may be held with the primary objective of generating a commercial return even though it does not meet that objective during a particular reporting period. Conversely, an asset may be a non-cash-generating asset even though it may be breaking even or generating a commercial return during a particular reporting period. Unless stated otherwise, references to "an asset" or "assets" in the following paragraphs of this Standard are references to "cash-generating asset(s)."

15. There are a number of circumstances in which public sector entities may hold some assets with the primary objective of generating a commercial return, although the majority of their assets are not held for that purpose. For example, a hospital may deploy a building for fee-paying patients. Cash-generating assets of a public sector entity may operate independently of the non-cash-generating assets of the entity. For example, the deeds office may earn land registration fees independently from the department of land affairs.

16. In certain instances, an asset may generate cash flows although it is primarily held for service delivery purposes. For example, a waste disposal plant is operated to ensure the safe disposal of medical waste generated by state-controlled hospitals, but the plant also treats a small amount of medical waste generated by other private hospitals on a commercial basis. The treatment of medical waste from the private hospitals is incidental to the activities of the plant, and the assets that generate cash flows cannot be distinguished from the non-cash-generating assets.

17. In other instances an asset may generate cash flows and also be used for non-cash-generating purposes. For example, a public hospital has ten wards, nine of which are used for fee-paying patients on a commercial basis, and the other is used for non-fee-paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 21. If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies this Standard, rather than IPSAS 21.

18. In some cases it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases it is necessary to evaluate the significance of the cash flows. It may be difficult to determine

whether the extent to which the asset generates cash flows is so significant that this Standard is applicable, rather than IPSAS 21. Judgment is needed to determine which Standard to apply. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets and with the related guidance in paragraphs 14–17. Paragraph 114 requires an entity to disclose the criteria used in making this judgment. However, given the overall objectives of most public sector entities other than GBEs, the presumption is that assets are non-cash-generating in these circumstances and, therefore, IPSAS 21 will apply.

Depreciation

19. Depreciation and amortization are the systematic allocation of the depreciable amount of an asset over its useful life. In the case of an intangible asset, the term "amortization" is generally used instead of "depreciation." Both terms have the same meaning.

Impairment

20. This Standard defines an "impairment" as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation. Impairment of a cash-generating asset, therefore, reflects a decline in the future economic benefits or service potential embodied in an asset to the entity that controls it. For example, an entity may have a municipal parking garage that is currently being used at 25 percent of capacity. It is held for commercial purposes, and management has estimated that it generates a commercial rate of return when usage is at 75 percent of capacity and above. The decline in usage has not been accompanied by a significant increase in parking charges. The asset is regarded as impaired because its carrying amount exceeds its recoverable amount.

Identifying an Asset that may be Impaired

21. An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 25–27 describe some indications that an impairment loss may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. Except for the circumstances described in paragraph 23, this Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present.

22. **An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset**.

23. **Irrespective of whether there is any indication of impairment, an entity shall also test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during the reporting period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognized during the current reporting period, that intangible asset shall be tested for impairment before the end of the current reporting period.**

24. The ability of an intangible asset to generate sufficient future economic benefits or service potential to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

25. **In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications**:

External sources of information

(a) **During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;**

(b) **Significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic, or legal environment in which the entity operates, or in the market to which an asset is dedicated;**

(c) **Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially;**

Internal sources of information

(d) **Evidence is available of obsolescence or physical damage of an asset;**

(e) **Significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to**

which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite;

(e) **A decision to halt the construction of the asset before it is complete or in a usable condition; and**

(f) **Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.**

26. The list in paragraph 25 is not exhaustive. An entity may identify other indications that an asset may be impaired, and these would also require the entity to determine the asset's recoverable amount.

27. Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:

(a) Cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;

(b) Actual net cash flows or surplus or deficit flowing from the asset that are significantly worse than those budgeted;

(c) A significant decline in budgeted net cash flows or surplus, or a significant increase in budgeted loss, flowing from the asset; or

(d) Deficits or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

28. As indicated in paragraph 23, this Standard requires an intangible asset with an indefinite useful life or an intangible asset that is not yet available for use to be tested for impairment, at least annually. Apart from when the requirements in paragraph 23 apply, the concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated. For example, if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 25.

29. As an illustration of paragraph 28, if market interest rates or other market rates of return on investments have increased during the period, an entity is not required to make a formal estimate of an asset's recoverable amount in the following cases:

(a) If the discount rate used in calculating the asset's value in use is unlikely to be affected by the increase in these market rates. For example, increases in short-term interest rates may not have a material effect on the discount rate used for an asset that has a long remaining useful life.

(b) If the discount rate used in calculating the asset's value in use is likely to be affected by the increase in these market rates, but previous sensitivity analysis of recoverable amount shows that:

(i) It is unlikely that there will be a material decrease in recoverable amount because future cash flows are also likely to increase (for example, in some cases, an entity may be able to demonstrate that it adjusts its revenues (mainly exchange revenues) to compensate for any increase in market rates); or

(ii) The decrease in recoverable amount is unlikely to result in a material impairment loss.

30. If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortization) method, or the residual value for the asset needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognized for the asset.

Measuring Recoverable Amount

31. This Standard defines "recoverable amount" as the higher of an asset's fair value less costs to sell and its value in use. Paragraphs 32–70 set out the requirements for measuring recoverable amount. These requirements use the term "an asset" but apply equally to an individual asset or a cash-generating unit.

32. It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

33. It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value in use as its recoverable amount.

34. If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, as the future cash flows from continuing use of the asset until its disposal are likely to be negligible.

35. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs 85–90), unless either:

    (a) The asset's fair value less costs to sell is higher than its carrying amount; or

    (b) The asset is a part of a cash-generating unit but is capable of generating cash flows individually, in which case the asset's value in use can be estimated to be close to its fair value less costs to sell and the asset's fair value less costs to sell can be determined.

36. In some cases, estimates, averages and computational shortcuts may provide reasonable approximations of the detailed computations for determining fair value less costs to sell or value in use.

Measuring the Recoverable Amount of an Intangible Asset with an Indefinite Useful Life

37. Paragraph 23 requires an intangible asset with an indefinite useful life to be tested for impairment annually by comparing its carrying amount with its recoverable amount, irrespective of whether there is any indication that it may be impaired. However, the most recent detailed calculation of such an asset's recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period, provided all of the following criteria are met:

    (a) If the intangible asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets and is therefore tested for impairment as part of the cash-generating unit to which it belongs, the assets and liabilities making up that unit have not changed significantly since the most recent recoverable amount calculation;

    (b) The most recent recoverable amount calculation resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and

    (c) Based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the asset's carrying amount is remote.

Fair Value less Costs to Sell

38. The best evidence of an asset's fair value less costs to sell is the price in a binding sale agreement in an arm's length transaction, adjusted for

incremental costs that would be directly attributable to the disposal of the asset.

39. If there is no binding sale agreement but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, provided that there has not been a significant change in economic circumstances between the transaction date and the date as at which the estimate is made.

40. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available that reflects the amount that an entity could obtain, at the reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity considers the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale.

41. Costs of disposal, other than those that have been recognized as liabilities, are deducted in determining fair value less costs to sell. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits and costs associated with reducing or reorganizing a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

42. Sometimes, the disposal of an asset would require the buyer to assume a liability, and only a single fair value less costs to sell is available for both the asset and the liability. Paragraph 89 explains how to deal with such cases.

Value in Use

43. **The following elements shall be reflected in the calculation of an asset's value in use:**

    (a) **An estimate of the future cash flows the entity expects to derive from the asset;**

    (b) **Expectations about possible variations in the amount or timing of those future cash flows;**

    (c) **The time value of money, represented by the current market risk-free rate of interest;**

    (d) **The price for bearing the uncertainty inherent in the asset; and**

    (e) **Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.**

44. Estimating the value in use of an asset involves the following steps:

    (a) Estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and

    (b) Applying the appropriate discount rate to those future cash flows.

45. The elements identified in paragraph 43(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, i.e., the weighted average of all possible outcomes. The Application Guidance provides additional guidance on the use of present value techniques in measuring an asset's value in use.

Basis for Estimates of Future Cash Flows

46. **In measuring value in use, an entity shall:**

    (a) **Base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence;**

    (b) **Base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified; and**

    (c) **Estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.**

47. Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided that the effects of

subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

48. Detailed, explicit, and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that these projections are reliable, and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

49. Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts, using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information about patterns over a product or industry lifecycle. If appropriate, the growth rate is zero or negative.

50. When conditions are favorable, competitors may enter the market and restrict growth. Therefore, entities will have difficulty in exceeding the average historical growth rate over the long term (say, twenty years) for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used.

51. In using information from financial budgets/forecasts, an entity considers whether the information reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

Composition of Estimates of Future Cash Flows

52. **Estimates of future cash flows shall include:**

(a) **Projections of cash inflows from the continuing use of the asset;**

(b) **Projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and**

(c) **Net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.**

53. Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation. Therefore, if the discount rate includes the effect of price increases attributable to general inflation, future cash flows are estimated in nominal terms. If the discount rate

excludes the effect of price increases attributable to general inflation, future cash flows are estimated in real terms (but include future specific price increases or decreases).

54. Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

55. When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale. For example, this is the case for a building under construction or for a development project that is not yet completed.

56. To avoid double-counting, estimates of future cash flows do not include:

(a) Cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables); and

(b) Cash outflows that relate to obligations that have been recognized as liabilities (for example, payables, pensions, or provisions).

57. **Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:**

(a) **A future restructuring to which an entity is not yet committed; or**

(b) **Improving or enhancing the asset's performance.**

58. Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:

(a) Future cash outflows or related cost savings (for example, reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an entity is not yet committed; or

(b) Future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.

59. A restructuring is a program that is (a) planned and controlled by management, and (b) materially changes either the scope of the entity's activities or the manner in which those activities are carried out. IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, contains guidance clarifying when an entity is committed to a restructuring.

60. When an entity becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the entity is committed to the restructuring:

    (a) Its estimates of future cash inflows and cash outflows for the purpose of determining value in use reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts approved by management); and

    (b) Its estimates of future cash outflows for the restructuring are included in a restructuring provision in accordance with IPSAS 19.

61. Until an entity incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the increase in economic benefits or service potential associated with the expected cash outflow.

62. Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits or service potential expected to arise from the asset in its current condition. When a unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.

63. **Estimates of future cash flows shall not include:**

    (a) **Cash inflows or outflows from financing activities; or**

    (b) **Income tax receipts or payments.**

64. Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. Because the time value of money is considered by discounting the estimated future cash flows, these cash flows exclude cash inflows or outflows from financing activities. Similarly, since the discount rate is determined on a pre-tax basis, future cash flows are also determined on a pre-tax basis.

65. **The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life shall be the amount that an entity expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.**

66. The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life is determined in a similar way to an asset's fair value less costs to sell, except that, in estimating those net cash flows:

    (a) An entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used; and

    (b) The entity adjusts those prices for the effect of both future price increases due to general inflation and specific future price increases or decreases. However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, the entity also excludes this effect from the estimate of net cash flows on disposal.

Foreign Currency Future Cash Flows

67. Future cash flows are estimated in the currency in which they will be generated, and then discounted using a discount rate appropriate for that currency. An entity translates the present value using the spot exchange rate at the date of the value in use calculation.

Discount Rate

68. **The discount rate (rates) shall be a pre-tax rate (rates) that reflect(s) current market assessments of:**

    (a) **The time value of money, represented by the current risk-free rate of interest; and**

    (b) **The risks specific to the asset for which the future cash flow estimates have not been adjusted.**

69. A rate that reflects current market assessments of the time value of money and the risks specific to the asset is the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing, and risk profile equivalent to those that the entity expects to derive from the asset. This rate is estimated from the rate implicit in current market transactions for similar assets. However, the discount rate(s) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

70. When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. The Application Guidance provides additional guidance on estimating the discount rate in such circumstances.

Recognizing and Measuring an Impairment Loss of an Individual Asset

71. Paragraphs 72–75 set out the requirements for recognizing and measuring impairment losses for an individual asset. The recognition and measurement of impairment losses for cash-generating units are dealt with in paragraphs 76–97.

72. **If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss.**

73. **An impairment loss shall be recognized immediately in surplus or deficit**.

74. **When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognize a liability if, and only if, that is required by another Standard.**

75. **After the recognition of an impairment loss, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Cash-Generating Units

76. Paragraphs 77–97 set out the requirements for identifying the cash-generating unit to which an asset belongs and determining the carrying amount of, and recognizing impairment losses for, cash-generating units.

Identifying the Cash-Generating Unit to which an Asset Belongs

77. **If there is any indication that an asset may be impaired, the recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).**

78. The recoverable amount of an individual asset cannot be determined if:

    (a) The asset's value in use cannot be estimated to be close to its fair value less costs to sell (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and

    (b) The asset does not generate cash inflows that are largely independent of those from other assets and is not capable of generating cash flows individually.

    In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit.

79. As defined in paragraph 13, an asset's cash-generating unit is the smallest group of assets that (a) includes the asset, and (b) generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash-generating unit involves judgment. If recoverable amount cannot be determined for an individual asset, an entity identifies the lowest aggregation of assets that generate largely independent cash inflows.

80 Cash inflows are inflows of cash and cash equivalents received from parties external to the entity. In identifying whether cash inflows from an asset (or group of assets) are largely independent of the cash inflows from other assets (or groups of assets), an entity considers various factors, including how management (a) monitors the entity's operations (such as by product lines, businesses, individual locations, districts, or regional areas), or (b) makes decisions about continuing or disposing of the entity's assets and operations. The Implementation Guidance gives an example of the identification of a cash-generating unit.

81. **If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a cash-generating unit, even if some or all of the output is used internally. If the cash inflows generated by any asset or cash-generating unit are affected by internal transfer pricing, an entity shall use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:**

(a) **The future cash inflows used to determine the asset's or cash-generating unit's value in use; and**

(b) **The future cash outflows used to determine the value in use of any other assets or cash-generating units that are affected by the internal transfer pricing.**

82. Even if part or all of the output produced by an asset or a group of assets is used by other units of the entity (for example, products at an intermediate stage of a production process), this asset or group of assets forms a separate cash-generating unit if the entity could sell the output on an active market. This is because the asset or group of assets could generate cash inflows that would be largely independent of the cash inflows from other assets or groups of assets. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, or to any other asset or cash-generating unit affected by internal transfer pricing, an entity adjusts this information if internal transfer prices do not reflect management's best estimate of future prices that could be achieved in arm's length transactions.

83. **Cash-generating units shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified.**

84. If an entity determines that an asset belongs to a cash-generating unit different from that in previous periods, or that the types of assets aggregated for the asset's cash-generating unit have changed, paragraph 120 requires disclosures about the cash-generating unit if an impairment loss is recognized or reversed for the cash-generating unit.

Recoverable Amount and Carrying Amount of a Cash-Generating Unit

85. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs to sell and its value in use. For the purpose of determining the recoverable amount of a cash-generating unit, any reference in paragraphs 31–70 to an asset is read as a reference to a cash-generating unit.

86. **The carrying amount of a cash-generating unit shall be determined on a basis consistent with the way the recoverable amount of the cash-generating unit is determined.**

87. The carrying amount of a cash-generating unit:

    (a) Includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and will generate the future cash inflows used in determining the cash-generating unit's value in use; and

    (b) Does not include the carrying amount of any recognized liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability.

    This is because fair value less costs to sell and value in use of a cash-generating unit are determined excluding cash flows that relate to assets that are not part of the cash-generating unit and liabilities that have been recognized (see paragraphs 41 and 56).

88. When assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate, or are used to generate, the relevant stream of cash inflows. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. The Illustrated Decision Tree provides a flow diagram illustrating the treatment of individual assets that are part of cash-generating units.

89. It may be necessary to consider some recognized liabilities to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to assume the liability. In this case, the fair value less costs to sell (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the estimated selling price for the assets of the cash-generating unit and the liability together, less the costs of disposal. To perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying

amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount.

90. For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of (a) assets that are not part of the cash-generating unit (for example, receivables or other financial assets), or (b) liabilities that have been recognized (for example, payables, pensions and other provisions). In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Impairment Loss for a Cash-Generating Unit

91. **An impairment loss shall be recognized for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the cash-generating assets of the unit on a pro rata basis, based on the carrying amount of each asset in the unit. These reductions in carrying amounts shall be treated as impairment losses on individual assets and recognized in accordance with paragraph 73.**

92. **In allocating an impairment loss in accordance with paragraph 91, an entity shall not reduce the carrying amount of an asset below the highest of:**

(a) **Its fair value less costs to sell (if determinable);**

(b) **Its value in use (if determinable); and**

(c) **Zero.**

The amount of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other cash-generating assets of the unit.

93. **Where a non-cash-generating asset contributes to a cash-generating unit, a proportion of the carrying amount of that non-cash-generating asset shall be allocated to the carrying amount of the cash-generating unit prior to estimation of the recoverable amount of the cash-generating unit. The carrying amount of the non-cash-generating asset shall reflect any impairment losses at the reporting date that have been determined under the requirements of IPSAS 21.**

94. If the recoverable amount of an individual asset cannot be determined (see paragraph 78):

(a) An impairment loss is recognized for the asset if its carrying amount is greater than the higher of its fair value less costs to sell and the results of the allocation procedures described in paragraphs 91–93; and

(b) No impairment loss is recognized for the asset if the related cash-generating unit is not impaired. This applies even if the asset's fair value less costs to sell is less than its carrying amount.

95. In some cases, non-cash-generating assets contribute to cash-generating units. This Standard requires that, where a cash-generating unit subject to an impairment test contains a non-cash-generating asset, that non-cash-generating asset is tested for impairment in accordance with the requirements of IPSAS 21. A proportion of the carrying amount of that non-cash-generating asset, following that impairment test, is included in the carrying amount of the cash-generating unit. The proportion reflects the extent to which the service potential of the non-cash-generating asset contributes to the cash-generating unit. The allocation of any impairment loss for the cash-generating unit is then made on a pro rata basis to all cash-generating assets in the cash-generating unit, subject to the limits in paragraph 92. The non-cash-generating asset is not subject to a further impairment loss beyond that which has been determined in accordance with IPSAS 21.

96. Where an asset releases service potential to one or more cash-generating activities, but not to non-cash-generating activities, entities refer to the relevant international and national accounting standard dealing with such circumstances.

97. **After the requirements in paragraphs 91–93 have been applied, a liability shall be recognized for any remaining amount of an impairment loss for a cash-generating unit if, and only if, that is required by another standard.**

Reversing an Impairment Loss

98. Paragraphs 99–105 set out the requirements for reversing an impairment loss recognized for an asset or a cash-generating unit in prior periods. These requirements use the term "an asset," but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 106–109 and, for a cash-generating unit, in paragraphs 110 and 111.

99. **An entity shall assess at each reporting date whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset.**

100. **In assessing whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:**

External sources of information

(a) **The asset's market value has increased significantly during the period;**

(b) **Significant changes with a favorable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic, or legal environment in which the entity operates or in the market to which the asset is dedicated;**

(c) **Market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially;**

Internal sources of information

(d) **Significant changes with a favorable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs;**

(dA) **A decision to resume construction of the asset that was previously halted before it was completed or in a usable condition; and**

(e) **Evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.**

101. Indications of a potential decrease in an impairment loss in paragraph 100 mainly mirror the indications of a potential impairment loss in paragraph 25.

102. If there is an indication that an impairment loss recognized for an asset may no longer exist or may have decreased, this may indicate that (a) the remaining useful life, (b) the depreciation (amortization) method, or (c) the residual value may need to be reviewed and adjusted in accordance with the standard applicable to the asset, even if no impairment loss is reversed for the asset.

103. **An impairment loss recognized in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. That increase is a reversal of an impairment loss.**

104. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or from sale, since the date when an entity last recognized an impairment loss for that asset. An entity is required to identify the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include:

(a) A change in the basis for recoverable amount (i.e., whether recoverable amount is based on fair value less costs to sell or value in use);

(b) If recoverable amount was based on value in use, a change in the amount or timing of estimated future cash flows, or in the discount rate; or

(c) If recoverable amount was based on fair value less costs to sell, a change in estimate of the components of fair value less costs to sell.

105. An asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the unwinding of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Reversing an Impairment Loss for an Individual Asset

106. **The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years.**

107. Any increase in the carrying amount of an asset above the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years is a revaluation. In accounting for such a revaluation, an entity applies the standard applicable to the asset.

108. **A reversal of an impairment loss for an asset shall be recognized immediately in surplus or deficit**.

109. **After a reversal of an impairment loss is recognized, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Reversing an Impairment Loss for a Cash-Generating Unit

110. **A reversal of an impairment loss for a cash-generating unit shall be allocated to the cash-generating assets of the unit pro rata with the carrying amounts of those assets. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and**

recognized in accordance with paragraph 108. No part of the amount of such a reversal shall be allocated to a non-cash-generating asset contributing service potential to a cash-generating unit.

111. **In allocating a reversal of an impairment loss for a cash-generating unit in accordance with paragraph 110, the carrying amount of an asset shall not be increased above the lower of:**

   (a) **Its recoverable amount (if determinable); and**

   (b) **The carrying amount that would have been determined (net of amortization or depreciation) if no impairment loss had been recognized for the asset in prior periods.**

   The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit.

Redesignation of Assets

112. **The redesignation of an asset from a cash-generating asset to a non-cash-generating asset or from a non-cash-generating asset to a cash-generating asset shall only occur when there is clear evidence that such a redesignation is appropriate. A redesignation, by itself, does not necessarily trigger an impairment test or a reversal of an impairment loss. At the subsequent reporting date after a redesignation, an entity shall consider, as a minimum, the listed indications in paragraph 25.**

113. There are circumstances in which public sector entities may decide that it is appropriate to redesignate a cash-generating asset as a non-cash-generating asset. For example, an effluent treatment plant was constructed primarily to treat industrial effluent from an industrial estate at commercial rates, and excess capacity has been used to treat effluent from a social housing unit, for which no charge is made. The industrial estate has recently closed and, in future, the site will be developed for social housing purposes. In light of the closure of the industrial estate, the public sector entity decides to redesignate the effluent treatment plant as a non-cash-generating asset.

Disclosure

114. **An entity shall disclose the criteria developed by the entity to distinguish cash-generating assets from non-cash-generating assets.**

115. **An entity shall disclose the following for each class of assets:**

   (a) **The amount of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of financial performance in which those impairment losses are included.**

(b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of financial performance in which those impairment losses are reversed.**

116. In some cases it may be not be clear whether the primary objective of holding an asset is to generate a commercial return. That judgment is needed to determine whether to apply this Standard or IPSAS 21. Paragraph 114 requires the disclosure of the criteria used for distinguishing cash-generating and non-cash-generating assets.

117. A class of assets is 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.

118. The information required in paragraph 115 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant, and equipment at the beginning and end of the period, as required by IPSAS 17.

119. **An entity that reports segment information in accordance with IPSAS 18, *Segment Reporting*, shall disclose the following for each reported segment based on an entity's reporting format:**

(a) **The amount of impairment losses recognized in surplus or deficit during the period; and**

(b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period.**

120. **An entity shall disclose the following for each material impairment loss recognized or reversed during the period for a cash-generating asset or a cash-generating unit:**

(a) **The events and circumstances that led to the recognition or reversal of the impairment loss;**

(b) **The amount of the impairment loss recognized or reversed;**

(c) **For a cash-generating asset:**

(i) **The nature of the asset; and**

(ii) **If the entity reports segment information in accordance with IPSAS 18, the reported segment to which the asset belongs, based on the entity's reporting format.**

(d) **For a cash-generating unit:**

(i) **A description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, or a reported segment);**

(ii) **The amount of the impairment loss recognized or reversed by class of assets, and, if the entity reports segment information in accordance with IPSAS 18, by reported segment based on the entity's reporting format; and**

(iii) **If the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), a description of the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified.**

(e) **Whether the recoverable amount of the asset is its fair value less costs to sell or its value in use;**

(f) **If the recoverable amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market); and**

(g) **If the recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.**

121. **An entity shall disclose the following information for the aggregate impairment losses and the aggregate reversals of impairment losses recognized during the period for which no information is disclosed in accordance with paragraph 120:**

(a) **The main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses; and**

(b) **The main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.**

122. An entity is encouraged to disclose assumptions used to determine the recoverable amount of assets during the period. However, paragraph 123 requires an entity to disclose information about the estimates used to measure the recoverable amount of a cash-generating unit when an intangible asset with an indefinite useful life is included in the carrying amount of that unit.

Disclosure of Estimates used to Measure Recoverable Amounts of Cash-Generating Units Containing Intangible Assets with Indefinite Useful Lives

123. **An entity shall disclose the information required by (a)–(e) for each cash-generating unit for which the carrying amount of intangible assets with**

indefinite useful lives allocated to that unit is significant in comparison with the entity's total carrying amount of intangible assets with indefinite useful lives:

(a) **The carrying amount of intangible assets with indefinite useful lives allocated to the unit;**

(b) **The basis on which the unit's recoverable amount has been determined (i.e., value in use or fair value less costs to sell);**

(c) **If the unit's recoverable amount is based on value in use:**

  (i) **A description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's recoverable amount is most sensitive;**

  (ii) **A description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information;**

  (iii) **The period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit, an explanation of why that longer period is justified;**

  (iv) **The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit is dedicated; and**

  (v) **The discount rate(s) applied to the cash flow projections.**

(d) **If the unit's recoverable amount is based on fair value less costs to sell, the methodology used to determine fair value less costs to sell. If fair value less costs to sell is not determined using an observable market price for the unit, the following information shall also be disclosed:**

  (i) **A description of each key assumption on which management has based its determination of fair value less costs to sell.**

Key assumptions are those to which the unit's recoverable amount is most sensitive; and

(ii) **A description of management's approach to determining the value (or values) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.**

If fair value less costs to sell is determined using discounted cash flow projections, the following information shall also be disclosed:

(iii) **The period over which management has projected cash flows;**

(iv) **The growth rate used to extrapolate cash flow projections; and**

(v) **The discount rate(s) applied to the cash flow projections.**

(e) **If a reasonably possible change in a key assumption on which management has based its determination of the unit's recoverable amount would cause the unit's carrying amount to exceed its recoverable amount:**

(i) **The amount by which the unit's recoverable amount would exceed its carrying amount;**

(ii) **The value assigned to the key assumption; and**

(iii) **The amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's recoverable amount to be equal to its carrying amount.**

124. **If some or all of the carrying amount of intangible assets with indefinite useful lives is allocated across multiple cash-generating units, and the amount so allocated to each unit is not significant in comparison with the entity's total carrying amount of intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units. In addition, if (a) the recoverable amounts of any of those units are based on the same key assumption(s), and (b) the aggregate carrying amount of intangible assets with indefinite useful lives allocated to them is significant in comparison with the entity's total carrying amount of intangible assets with indefinite useful lives, an entity shall disclose that fact, together with:**

(a) **The aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units;**

(b) **A description of the key assumption(s);**

(c) **A description of management's approach to determining the value(s) assigned to the key assumption(s), whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and if not, how and why they differ from past experience or external sources of information;**

(d) **If a reasonably possible change in the key assumption(s) would cause the aggregate of the units' carrying amounts to exceed the aggregate of their recoverable amounts:**

(i) **The amount by which the aggregate of the units' recoverable amounts would exceed the aggregate of their carrying amounts;**

(ii) **The value(s) assigned to the key assumption(s); and**

(iii) **The amount by which the value(s) assigned to the key assumption(s) must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units' recoverable amounts to be equal to the aggregate of their carrying amounts.**

125. The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit may, in accordance with paragraph 37, be carried forward and used in the impairment test for that unit in the current period, provided specified criteria are met. When this is the case, the information for that unit that is incorporated into the disclosures required by paragraphs 123 and 124 relate to the carried forward calculation of recoverable amount.

Effective Date

126. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after April 1, 2009. Earlier application is encouraged. If an entity applies this Standard for a period beginning before April 1, 2009, it shall disclose that fact.**

126A. **Paragraphs 25 and 100 were amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply those amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged if an entity also applies the amendments to paragraphs 12, 13, 29, 40, 57, 59, 62, 62A, 62B, 63, 66, and 101A of IPSAS 16 at the same time. If an entity applies the**

amendments for a period beginning before January 1, 2011, it shall disclose that fact.

126B. **Paragraph 123 was amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2011, it shall disclose that fact.**

126C. **IPSAS 31 amended paragraph 2(h). An entity shall apply that amendment for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies IPSAS 31 for a period beginning before April 1, 2011, the amendment shall also be applied for that earlier period.**

126D. **Paragraph 127 was amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendment shall also be applied for that earlier period.**

126E. **IPSAS 35, *Consolidated Financial Statements* and IPSAS 37, *Joint Arrangements* issued in January 2015, amended paragraph 12. An entity shall apply that amendment when it applies IPSAS 35 and IPSAS 37.**

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

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 26.

Using Present Value Techniques to Measure Value in Use

This guidance uses the term "asset," but equally applies to a group of assets forming a cash-generating unit.

The Components of a Present Value Measurement

AG1. The following elements together capture the economic differences between cash-generating assets:

(a) An estimate of the future cash flow, or, in more complex cases, series of future cash flows that the entity expects to derive from the asset;

(b) Expectations about possible variations in the amount or timing of those cash flows;

(c) The time value of money, represented by the current market risk-free rate of interest;

(d) The price for bearing the uncertainty inherent in the asset; and

(e) Other, sometimes unidentifiable, factors (such as illiquidity) that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

AG2. This appendix contrasts two approaches to computing present value, either of which may be used to estimate the value in use of an asset, depending on the circumstances. Under the traditional approach, adjustments for factors (b)–(e) described in paragraph A1 are embedded in the discount rate. Under the expected cash flow approach, factors (b), (d) and (e) cause adjustments in arriving at risk-adjusted expected cash flows. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result should be to reflect the expected present value of the future cash flows, i.e., the weighted average of all possible outcomes.

General Principles

AG3. The techniques used to estimate future cash flows and interest rates will vary from one situation to another depending on the circumstances surrounding the asset in question. However, the following general principles govern any application of present value techniques in measuring assets:

(a) Interest rates used to discount cash flows should reflect assumptions that are consistent with those inherent in the estimated cash flows. Otherwise, the effect of some assumptions will be double-counted or ignored. For example, a discount rate of 12 percent might be applied to contractual cash flows of a loan receivable. That rate reflects expectations about future defaults from loans with particular characteristics. That same 12 percent rate should not be used to discount expected cash flows, because those cash flows already reflect assumptions about future defaults.

(b) Estimated cash flows and discount rates should be free from both bias and factors unrelated to the asset in question. For example, deliberately understating estimated net cash flows to enhance the apparent future profitability of an asset introduces a bias into the measurement.

(c) Estimated cash flows or discount rates should reflect the range of possible outcomes rather than a single most likely minimum or maximum possible amount.

Traditional and Expected Cash Flow Approaches to Present Value

Traditional Approach

AG4. Accounting applications of present value have traditionally used a single set of estimated cash flows and a single discount rate, often described as the rate commensurate with the risk. In effect, the traditional approach assumes that a single discount rate convention can incorporate all the expectations about the future cash flows and the appropriate risk premium. Therefore, the traditional approach places most of the emphasis on selection of the discount rate.

AG5. In some circumstances, such as those in which comparable assets can be observed in the marketplace, a traditional approach is relatively easy to apply. For assets with contractual cash flows, it is consistent with the manner in which marketplace participants describe assets, as in a 12 percent bond.

AG6. However, the traditional approach may not appropriately address some complex measurement problems, such as the measurement of non-financial assets for which no market for the item or a comparable item exists. A proper search for the rate commensurate with the risk requires analysis of at least two items − an asset that exists in the marketplace and has an observed interest rate and the asset being measured. The appropriate discount rate for the cash flows being measured must be inferred from the observable rate of interest in that other asset. To draw that inference, the characteristics of the other asset’s cash flows must be similar to those of the asset being measured. Therefore, the measurer must do the following:

(a) Identify the set of cash flows that will be discounted;

(b) Identify another asset in the marketplace that appears to have similar cash flow characteristics;

(c) Compare the cash flow sets from the two items to ensure that they are similar (for example, are both sets contractual cash flows, or is one contractual and the other an estimated cash flow?);

(d) Evaluate whether there is an element in one item that is not present in the other (for example, is one less liquid than the other?); and

(e) Evaluate whether both sets of cash flows are likely to behave (i.e., vary) in a similar fashion in changing economic conditions.

Expected Cash Flow Approach

AG7. The expected cash flow approach is, in some situations, a more effective measurement tool than the traditional approach. In developing a measurement, the expected cash flow approach uses all expectations about possible cash flows instead of the single most likely cash flow. For example, a cash flow might be CU100,[1] CU200, or CU300, with probabilities of 10 percent, 60 percent and 30 percent, respectively. The expected cash flow is CU220. The expected cash flow approach thus differs from the traditional approach by focusing on direct analysis of the cash flows in question and on more explicit statements of the assumptions used in the measurement.

AG8. The expected cash flow approach also allows use of present value techniques when the timing of cash flows is uncertain. For example, a cash flow of CU1,000 may be received in one year, two years, or three years, with probabilities of 10 percent, 60 percent, and 30 percent, respectively. The example below shows the computation of expected present value in that situation.

Present value of CU1,000 in 1 year at 5%	CU952.38	
Probability	10 %	CU95.24
Present value of CU1,000 in 2 years at 5.25%	CU902.73	
Probability	60 %	CU541.64
Present value of CU1,000 in 3 years at 5.50%	CU851.61	
Probability	30.%	CU255.48
Expected present value		CU892.36

[1] In this and other examples monetary amounts are denominated in currency units (CU).

AG9. The expected present value of CU892.36 differs from the traditional notion of a best estimate of CU902.73 (the 60 percent probability). A traditional present value computation applied to this example requires a decision about which of the possible timings of cash flows to use and, accordingly, which would not reflect the probabilities of other timings. This is because the discount rate in a traditional present value computation cannot reflect uncertainties in timing.

AG10. The use of probabilities is an essential element of the expected cash flow approach. Some question whether assigning probabilities to highly subjective estimates suggests greater precision than, in fact, exists. However, the proper application of the traditional approach (as described in paragraph A6) requires the same estimates and subjectivity without providing the computational transparency of the expected cash flow approach.

AG11. Many estimates developed in current practice already incorporate the elements of expected cash flows informally. In addition, accountants often face the need to measure an asset using limited information about the probabilities of possible cash flows. For example, an accountant might be confronted with the following situations:

(a) The estimated amount falls somewhere between CU50 and CU250, but no amount in the range is more likely than any other amount. Based on that limited information, the estimated expected cash flow is CU150 [(50+250)/2];

(b) The estimated amount falls somewhere between CU50 and CU250, and the most likely amount is CU100. However, the probabilities attached to each amount are unknown. Based on that limited information, the estimated expected cash flow is CU133.33 [(50+100+250)/3]; or

(c) The estimated amount will be CU50 (10 percent probability), CU250 (30 percent probability), or CU100 (60 percent probability). Based on that limited information, the estimated expected cash flow is CU140 [(50 × 0.10)+(250 × 0.30)+(100 × 0.60)]. In each case, the estimated expected cash flow is likely to provide a better estimate of value in use than the minimum, most likely, or maximum amount taken alone.

AG12. The application of an expected cash flow approach is subject to a cost-benefit constraint. In some cases, an entity may have access to extensive data and may be able to develop many cash flow scenarios. In other cases, an entity may not be able to develop more than general statements about the variability of cash flows without incurring substantial cost. The entity needs to balance the cost of obtaining additional information against the additional reliability that information will bring to the measurement.

AG13. Some maintain that expected cash flow techniques are inappropriate for measuring a single item or an item with a limited number of possible outcomes. They offer an example of an asset with two possible outcomes: a 90 percent probability that the cash flow will be CU10 and a 10 percent probability that the cash flow will be CU1,000. They observe that the expected cash flow in that example is CU109, and criticize that result as not representing either of the amounts that may ultimately be paid.

AG14. Assertions like the one just outlined reflect underlying disagreement with the measurement objective. If the objective is accumulation of costs to be incurred, expected cash flows may not produce a representationally faithful estimate of the expected cost. However, this Standard is concerned with measuring the recoverable amount of an asset. The recoverable amount of the asset in this example is not likely to be CU10, even though that is the most likely cash flow. This is because a measurement of CU10 does not incorporate the uncertainty of the cash flow in the measurement of the asset. Instead, the uncertain cash flow is presented as if it were a certain cash flow. No rational entity would sell an asset with these characteristics for CU10.

Discount Rate

AG15. Whichever approach an entity adopts for measuring the value in use of an asset, interest rates used to discount cash flows should not reflect risks for which the estimated cash flows have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

AG16. When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. The purpose is to estimate, as far as possible, a market assessment of:

(a) The time value of money for the periods until the end of the asset's useful life; and

(b) Factors (b), (d) and (e) described in paragraph AG1, to the extent those factors have not caused adjustments in arriving at estimated cash flows.

AG17. As a starting point in making such an estimate, the entity might take into account the following rates:

(a) The entity's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model;

(b) The entity's incremental borrowing rate; and

(c) Other market borrowing rates.

AG18. However, these rates must be adjusted:

(a) To reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows; and

(b) To exclude risks that are not relevant to the asset's estimated cash flows or for which the estimated cash flows have been adjusted. Consideration should be given to risks such as country risk, currency risk, and price risk.

AG19. The discount rate is independent of the entity's capital structure and the way the entity financed the purchase of the asset, because the future cash flows expected to arise from an asset do not depend on the way in which the entity financed the purchase of the asset.

AG20. Paragraph 68 requires the discount rate used to be a pre-tax rate. Therefore, when the basis used to estimate the discount rate is post-tax, that basis is adjusted to reflect a pre-tax rate.

AG21. An entity normally uses a single discount rate for the estimate of an asset's value in use. However, an entity uses separate discount rates for different future periods where value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.

Appendix B

Amendments to Other IPSASs

IPSAS 21, *Impairment of Non-Cash-Generating Assets*, is amended as follows (deleted text is struck through and new text is underlined)

Paragraphs 5 and 6 are amended:

5. **Public sector entities that hold cash-generating assets as defined in paragraph 14 shall apply ~~International Accounting Standard IAS 36~~, ~~"Impairment of Assets"~~ IPSAS 26, *Impairment of Cash-Generating Assets* to such assets. Public sector entities that hold non-cash-generating assets shall apply the requirements of this Standard to non-cash-generating assets.**

6. This Standard excludes from its scope the impairment of assets that are dealt with in another International Public Sector Accounting Standard. GBEs apply IAS 36, *Impairment of Assets* and therefore are not subject to the provisions of this Standard. Public sector entities other than GBEs apply ~~IAS 36~~ IPSAS 26 to their cash-generating assets and apply this Standard to their non-cash-generating assets. Paragraphs 6 to 13 explain the scope of this Standard in greater detail.

Paragraph 14 is amended:

Cash-generating assets are assets held ~~to generate~~ with the primary objective of generating a commercial return.

Paragraph 16 is deleted:

~~16. Cash-generating assets are those that are held to generate a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Holding an asset to generate a "commercial return" indicates that an entity intends to generate positive cash inflows from the asset (or of the unit of which the asset is a part) and earn a return that reflects the risk involved in holding the asset.~~

The following paragraphs are added:

16. Cash-generating assets are assets held with the primary objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Holding an asset to generate a "commercial return" indicates that an entity intends to generate positive cash inflows from the asset (or from the cash-generating unit of which the asset is a part) and earn a commercial return that reflects the risk involved in holding the asset. An asset may be held with the primary objective of generating a commercial return even though it does not meet that objective during a particular reporting period. Conversely, an

asset may be a non-cash-generating asset even though it may be breaking even or generating a commercial return during a particular reporting period. Unless stated otherwise, references to "an asset" or "assets" in the following paragraphs of this Standard are references to "non-cash-generating asset(s).

17. There are a number of circumstances in which public sector entities may hold some assets with the primary objective of generating a commercial return, although the majority of assets are not held for that purpose. For example, a hospital may deploy a building for fee-paying patients. Cash-generating assets of a public sector entity may operate independently of the non-cash-generating assets of the entity. For example, the deeds office may earn land registration fees independently from the department of land affairs.

18. In certain instances, an asset may generate cash flows although it is primarily held for service delivery purposes. For example, a waste disposal plant is operated to ensure the safe disposal of medical waste generated by state controlled hospitals, but the plant also treats a small amount of medical waste generated by other private hospitals on a commercial basis. The treatment of medical waste from the private hospitals is incidental to the activities of the plant, and the assets that generate cash flows cannot be distinguished from the non-cash-generating assets.

19. In other instances, an asset may generate cash flows and also be used for non-cash-generating purposes. For example, a public hospital has ten wards, nine of which are used for fee-paying patients on a commercial basis, and the other is used for non-fee paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 26, *Impairment of Cash-Generating Assets*. If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies IPSAS 26 rather than this Standard.

20. In some cases it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases it is necessary to evaluate the significance of the cash flows. It may be difficult to determine whether the extent to which the asset generates cash flows is so significant that this Standard is applicable rather than IPSAS 26. Judgment is needed to determine which Standard to apply. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets and with the related guidance in paragraphs 16A–16E. Paragraph 67B requires an entity to disclose the criteria used in making this judgment. However, given the overall objectives of most public sector entities, other than GBEs, the presumption is that assets are non-cash-generating and, therefore, IPSAS 21 will apply.

Paragraph 71 is redesignated as black letter:

71. **The redesignation of assets from cash-generating assets to non-cash-generating assets or from non-cash-generating assets to cash-generating assets shall only occur when there is clear evidence that such a redesignation is appropriate. A redesignation, by itself, does not necessarily trigger an impairment test or a reversal of an impairment loss. Instead, the indication for an impairment test or a reversal of an impairment loss arises from, as a minimum, the listed indications applicable to the asset after redesignation.**

The following paragraphs are added:

72. There are circumstances in which public sector entities may decide that it is appropriate to redesignate a non-cash-generating asset as a cash-generating asset. For example, an effluent treatment plant was constructed primarily to treat industrial effluent from a social housing unit, for which no charge is made. The social housing unit has been demolished and the site will be developed for industrial and retail purposes. It is intended that, in future, the plant will be used to treat industrial effluent at commercial rates. In light of this decision the public sector entity decides to redesignate the effluent treatment plant as a cash-generating asset.

72A. **An entity shall disclose the criteria developed by the entity to distinguish non-cash-generating assets from cash-generating assets.**

In the Basis for Conclusions the following paragraphs are amended:

BC5. IAS 36 requires an entity to determine value in use as the present value of estimated future cash flows expected to be derived from the continuing use of the asset, or cash-generating unit, and from its disposal at the end of its useful life. The service potential of cash-generating assets is reflected by their ability to generate future cash flows. IPSAS 26 is based on IAS 36. The requirements of ~~IAS 36~~ IPSAS 26 are applicable to cash-generating assets held by public sector entities. This Standard requires entities to apply ~~IAS 36~~ IPSAS 26 to account for the impairment of cash-generating assets in the public sector.

In the Basis for Conclusions the following paragraph is deleted:

~~C20 This Standard requires the impairment of cash-generating assets to be dealt with under IAS 36. IAS 36 applies to property, plant and equipment carried at revalued amounts. Therefore, this Standard does not exempt cash-generating property, plant and equipment carried at revalued amounts from an impairment test.~~

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 26.

Development of IPSAS 26 based on the IASB's revised version of IAS 36 issued in 2004

Introduction

BC1. The IPSASB's IFRS Convergence Program is an important element in the 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. The IPSASB issued IPSAS 21, *Impairment of Non-Cash-Generating Assets*, in December 2004. IPSAS 21 prescribes the procedures that an entity applies to determine whether a non-cash-generating asset is impaired, and establishes how the impairment is recognized and measured. The majority of assets in the public sector are non-cash-generating, and the recognition and measurement requirements developed resulted in a number of differences in IPSAS 21 from International Accounting Standard, IAS 36, *Impairment of Assets*.

Need for this Standard

BC3. IPSAS 21 referred readers to IAS 36 (a) in order to establish whether cash-generating assets have been impaired, and (b) for accounting for the recognition and measurement of any impairment. There are benefits in incorporating requirements and guidance on the impairment of cash-generating assets in an IPSAS, so that public sector entities do not have to refer to IAS 36 when an entity has cash-generating assets. In addition, there are a number of public sector issues related to impairment. These include:

(a) Whether cash-generating property, plant, and equipment carried in accordance with the revaluation model in IPSAS 17, *Property, Plant, and Equipment* should be within the scope;

(b) Distinguishing cash-generating and non-cash-generating assets;

(c) The redesignation of cash-generating assets to non-cash-generating assets and vice-versa; and

(d) The treatment for impairment purposes of non-cash-generating assets in cash-generating units.

Exclusion of Property, Plant, and Equipment Carried at Revalued Amounts and Intangible Assets that are Regularly Revalued to Fair Value from Scope

BC4. The scope of IPSAS 21 excludes non cash-generating property, plant, and equipment carried at revalued amounts in accordance with the revaluation model in IPSAS 17. The Basis for Conclusions in IPSAS 21 states that the IPSASB is of the view that assets carried at revalued amounts in accordance with the revaluation model in IPSAS 17 will be revalued with sufficient regularity to ensure (a) that they are carried at an amount that is not materially different from their fair value at the reporting date, and (b) that any impairment will be taken into account in that valuation. The IPSASB therefore considered whether a similar scope exclusion should be included in this Standard.

BC5. The IPSASB acknowledged that property, plant, and equipment held on the revaluation model are within the scope of IAS 36, and considered the view that guidance on determining impairment losses for such assets would be appropriate for public sector entities with assets on the revaluation model. The IPSASB noted that in IAS 36, in cases where the fair value of an item of property, plant and equipment is its market value, the maximum amount of an impairment loss is the disposal costs. In the Basis for Conclusions for IPSAS 21, it is stated that "the IPSASB is of the view that, in most cases, these will not be material and, from a practical viewpoint, it is not necessary to measure an asset's recoverable service amount and to recognize an impairment loss for the disposal costs of a non-cash-generating asset." The IPSASB considered that disposal costs are also unlikely to be material for cash-generating assets.

BC6. For specialized cash-generating assets where fair value has not been derived from market value, IAS 36 requires recoverability to be estimated through the value in use. Because value in use is based on cash flow projection, it might be materially greater or lower than carrying amount. This analysis is also relevant in the public sector. However, it is questionable whether public sector entities hold specialized assets that meet the definition of a cash-generating asset in this Standard.

BC7. The IPSASB remains of the view that it would be onerous to impose a requirement to test for impairment in addition to the existing requirement in IPSAS 17, i.e., that assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date. Therefore, on balance, the IPSASB concluded that consistency with IPSAS 21 should take precedence over convergence with IAS 36, and that property, plant and equipment carried on the revaluation model in IPSAS 17 should be excluded from the scope of this Standard. Consistent with the approach to property, plant, and equipment, intangible assets that are regularly revalued to fair value are also excluded from the scope.

Exclusion of Goodwill from Scope

BC8. IAS 36 contains extensive requirements and guidance on (a) the impairment of goodwill, (b) the allocation of goodwill to cash-generating units, and (c) testing cash-generating units with goodwill for impairment. The IPSASB considered whether goodwill should be within the scope of this Standard. The IPSASB has not yet issued an IPSAS dealing with entity combinations and considers it likely that a number of public sector-specific issues will arise when combinations of public sector entities take place: in particular, whether an acquirer can always be identified in combinations of public sector entities. The IPSASB concluded that goodwill should not be within the scope of this Standard. In accordance with the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors,* users are referred to the requirements of the relevant international or national accounting standards dealing with the impairment of goodwill, the allocation of goodwill to cash-generating units, and the testing for impairment of cash-generating units with goodwill.

Distinguishing Cash-Generating and Non-Cash-Generating Assets

BC9. The IPSASB noted that some assets have both cash-generating and non-cash-generating characteristics. The IPSASB considered whether it should adopt a components-based approach that would identify the cash-generating and non-cash-generating components of assets and subject them to different treatments. The IPSASB rejected such an approach because of cost-benefit considerations. The IPSASB concluded that assets in the public sector are generally non-cash-generating, and that an analysis of their service potential is the preferred basis to determine impairment. This Standard therefore includes a rebuttable presumption at paragraph 18 that assets that are both cash-generating and non-cash-generating should be treated as non-cash-generating assets.

Indications of Impairment: Market Capitalization

BC10. The IPSASB considered whether the indications for impairment of cash-generating assets held by public sector entities – both external sources and internal sources of information – are similar to those in IAS 36. The IPSASB concluded that the indications in IAS 36 are relevant, except for the indication that the carrying amount of the net assets of the entity is more than its market capitalization. The IPSASB is of the view that very few public sector entities that are not GBEs will issue equity instruments traded in deep markets, and that such an indication will therefore only be relevant on the consolidation of GBEs.

Fair Value less Costs to Sell and Forced Sales

BC11. In commentary on the definition of "fair value less costs to sell," IAS 36 states that "fair value less costs to sell does not reflect a forced sale," but includes a qualification: "unless management is compelled to sell immediately." IPSAS 26 does not include this qualification in paragraph 40 because there are very few circumstances in which public sector entities that are not GBEs will be forced to sell immediately in order to remain a going concern.

Redesignation of Assets

BC12. Cash-generating assets can become non-cash-generating assets and vice-versa. The IPSASB considered under what circumstances a redesignation of an asset from cash-generating to non-cash-generating and vice-versa should be permitted. The IPSASB concluded that a redesignation can occur only when there is clear evidence that it is appropriate. The IPSASB also concluded that a redesignation by itself does not trigger an impairment test or the reversal of an impairment loss. Instead, at the subsequent reporting date, an entity should evaluate the appropriate indicators following redesignation to determine if a test is needed. These requirements are stated in paragraph 112.

Cash-Generating Units

BC13. As in IAS 36, where it is not possible to determine the recoverable amount for an individual asset, then the recoverable amount for the asset's cash-generating unit (CGU) will be determined. The CGU is the smallest identifiable group of assets (a) that generates cash inflows from continuing use, and (b) that is largely independent of the cash inflows from other assets or groups of assets. The IPSASB concluded that the notion of a CGU is appropriate for cash-generating assets in a public sector context.

Corporate Assets

BC14. IAS 36 includes requirements related to corporate assets. Corporate assets are defined in IAS 36 as "assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units"—that is, a corporate asset contributes only to CGUs and not to non-cash-generating activities. The IPSASB considered whether this Standard should include requirements for corporate assets as defined in IAS 36.

BC15. The primary purpose of public sector entities that are not GBEs is not the generation of commercial returns. Therefore, the IPSASB considers that there will be very few occasions in which an asset shared between different activities (such as an administrative building) contributes service potential to CGUs without also contributing service potential to non-cash-generating activities. It was therefore decided that it is not necessary to define, and provide requirements for, corporate assets in this Standard. Paragraph 96 refers entities to the relevant international and national accounting standard dealing with assets that do not generate cash flows independently of other assets and form part of more than one cash-generating unit, but do not contribute service potential to non-cash-generating activities.

Treatment of Non-Cash-Generating Assets in Cash-Generating Units

BC16. There are likely to be a number of cases in which public sector entities hold non-cash-generating assets that contribute service potential to CGUs in addition to non-cash-generating activities. The IPSASB considered the approach to the treatment of such non-cash-generating assets in CGUs. In particular, the IPSASB considered whether it is appropriate to include a proportion of the carrying amount of a non-cash-generating asset, following any impairment test under IPSAS 21, in the carrying amount of the CGU when comparing the carrying amount of that CGU with its recoverable amount.

BC17. The IPSASB concluded that a proportion of the carrying amount of such a non-cash-generating asset should be included in the carrying amount of the CGU. That proportion should be determined on a basis pro rata to the service potential that such an asset contributes to the CGU. If the non-cash-generating asset is ignored, the carrying amount of the CGU may be understated and impairment losses not recognized. However, because any impairment of the non-cash-generating asset will have been determined in accordance with IPSAS 21, the non-cash-generating asset will have been written down to its recoverable service amount. Therefore, no further impairment loss relating to the CGU should be applied to the non-cash-generating asset. Any impairment losses are allocated on a pro rata basis, based on carrying values, to the cash-generating assets in the CGU, subject to the limits in paragraph 92. This approach is reflected in paragraph 95.

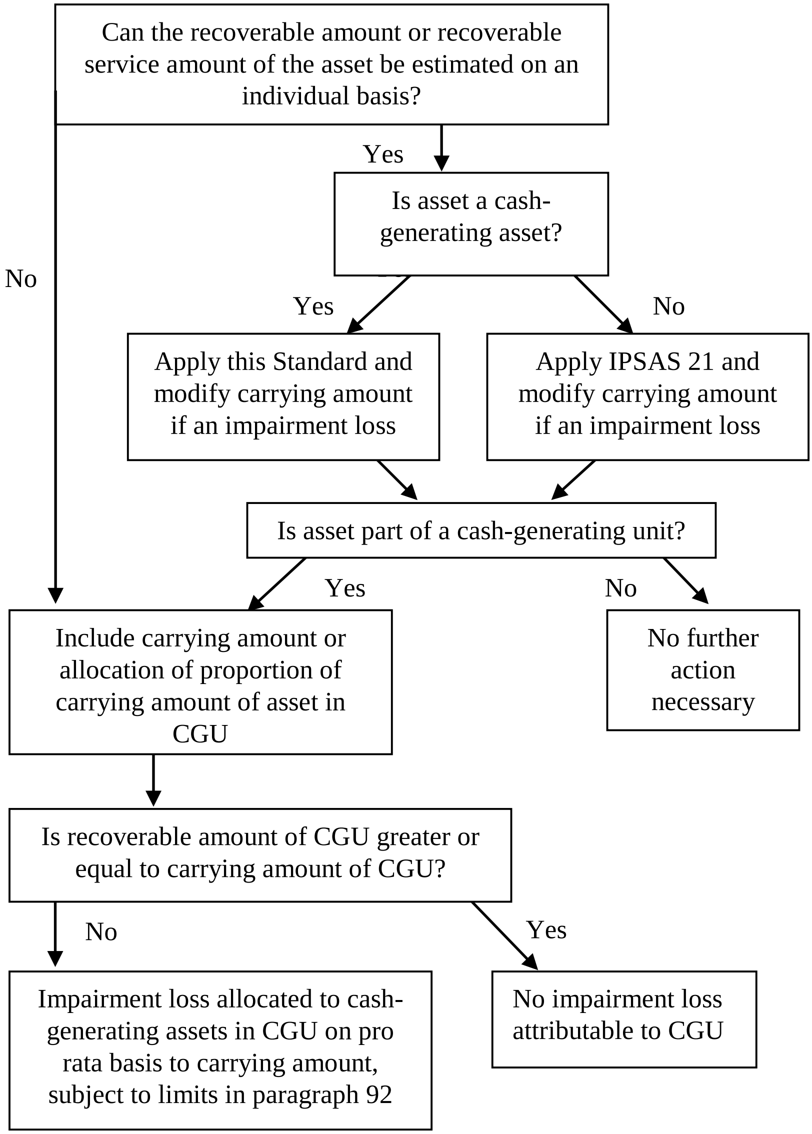
Revision of IPSAS 26 as a result of the IASB's Improvements to IFRSs issued in 2008

BC18. The IPSASB reviewed the revisions to IAS 36 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendment.

Illustrative Decision Tree

This decision tree accompanies, but is not part of, IPSAS 26.

For simplicity and clarity, this flowchart assumes that any asset that is part of a CGU also contributes service potential to non-cash-generating activities. When an asset only contributes service potential to one or more CGUs, but not to non-cash-generating activities, entities refer to the relevant international and national accounting standard dealing with such circumstances in accordance with paragraph 96.



Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 26.

Most assets held by public sector entities are non-cash-generating assets, and accounting for their impairment should be undertaken in accordance with IPSAS 21.

In those circumstances when an asset held by a public sector entity is held with the objective of generating a commercial return, the provisions of this Standard should be followed. Most cash-generating assets will arise in business activities run by government agencies that do not meet the definition of a GBE. An example is a seed-producing unit run on a commercial basis that is part of an agricultural research entity.

For the purposes of all these examples, a public sector entity that is not a GBE undertakes commercial activities.

Identification of Cash-Generating Units

The purpose of this example is:

(a) *To indicate how cash-generating units are identified in various situations; and*

(b) *To highlight certain factors that an entity may consider in identifying the cash-generating unit to which an asset belongs.*

A—Reduction in Demand Related to a Single-Product Unit

Background

IG1. A government has an electricity-generating utility. The utility has two turbine generators in a single electric plant. In the current period, a major manufacturing plant in the area closed and demand for power was significantly reduced. In response, the government shut down one of the generators.

Analysis

IG2. The individual turbine generators do not generate cash flows in and of themselves. Therefore the cash-generating unit to be used in determining an impairment is the electric plant as a whole.

B—Government Air Freight Unit that Leases an Aircraft

Background

IG3. M is the air freight unit of a government entity. It operates three aircraft, a landing strip, and a number of hangers and other buildings, including maintenance and fueling facilities. Because of declining demand for its services, M leases one aircraft for a five-year period to a private sector entity.

Under the terms of the lease, M is required to allow the lessee to use the landing strip and is responsible for all maintenance to the aircraft.

Analysis

IG4. Because of the terms of the lease, the leased aircraft cannot be considered to generate cash inflows that are largely independent of the cash inflows from M as a whole. Therefore, it is likely that the cash-generating unit to which the aircraft belongs is M as a whole.

C—Crushing Plant in Waste Disposal Entity

Background

IG5. A municipality runs a waste disposal entity that owns a crushing plant to support its waste disposal activities. The crushing plant could be sold only for scrap value, and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the waste disposal entity.

Analysis

IG6. It is not possible to estimate the recoverable amount of the crushing plant, because its value in use cannot be determined and is probably different from the scrap value. Therefore, the entity estimates the recoverable amount of the cash-generating unit to which the crushing plant belongs, i.e., the waste disposal entity as a whole.

D—Routes Provided by Bus Company

Background

IG7. A state bus company provides services under contract with a municipality that specifies minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Analysis

IG8. Because the entity does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the five routes together. The cash-generating unit is the bus company as a whole.

Calculation of Value in Use and Recognition of an Impairment Loss

Background and Calculation of Value in Use

IG9. At the beginning of 20X0, Government R, through its Department of Power, puts into service a power plant that it constructed for CU250 million.

IG10. At the beginning of 20X4, power plants constructed by competitors are put into service, resulting in a reduction in the revenues produced by the power plant of Government R. Reductions in revenue result because the volume of electricity generated has decreased from expectations, and also because the prices for electricity and stand-by capacity have decreased from expectations.

IG11. The reduction in revenue is evidence that the economic performance of the asset is worse than expected. Consequently, Government R is required to determine the asset's recoverable amount.

IG12. Government R uses straight-line depreciation over a 20-year life for the power plant and anticipates no residual value.

IG13. It is not possible to determine the fair value less costs to sell of the power plant. Therefore, recoverability can only be determined through the calculation of value in use. To determine the value in use for the power plant (see Schedule 1), Government R:

(a) Prepares cash flow forecasts derived from the most recent financial budgets/forecasts for the next five years (years 20X5-20X9) approved by management;

(b) Estimates subsequent cash flows (years 20Y0–20Y9) based on declining growth rates ranging from -6 percent per annum to -3 percent per annum; and

(c) Selects a 6 percent discount rate, which represents a rate that reflects current market assessments of the time value of money and the risks specific to Government R's power plant.

Recognition and Measurement of Impairment Loss

IG14. The recoverable amount of Government R's power plant is CU121.1 million.

IG15. Government R compares the recoverable amount of the power plant to its carrying amount (see Schedule 2).

IG16. Because the carrying amount exceeds the recoverable amount by CU78.9 million, an impairment loss of CU78.9 million is recognized immediately in surplus or deficit.

Schedule 1—Calculation of the Value in Use of Government R's Power Plant at the End of 20X4

Year	Long-term growth rates	Future cash flows	Present value factor at 6% discount rate§	Discounted future cash flows (CUm)
20X5 (n=1)		16.8 *	0.94340	15.8
20X6		14.4 *	0.89000	12.8
20X7		14.2 *	0.83962	11.9
20X8		14.1 *	0.79209	11.2
20X9		13.9 *	0.74726	10.4
20Y0	(6%)	13.1 †	0.70496	9.2
20Y1	(6%)	12.3 †	0.66506	8.2
20Y2	(6%)	11.6 †	0.62741	7.3
20Y3	(5%)	11.0 †	0.59190	6.5
20Y4	(5%)	10.5 †	0.55839	5.9
20Y5	(5%)	10.0 †	0.52679	5.3
20Y6	(4%)	9.6 †	0.49697	4.8
20Y7	(4%)	9.2 †	0.46884	4.3
20Y8	(3%)	8.9 †	0.44230	3.9
20Y9	(3%)	8.6 †	0.41727	3.6
Value in use				**121.1**

* Based on management's best estimate of net cash flow projections.

† Based on an extrapolation from preceding year cash flow using declining growth rates.

§ The present value factor is calculated as $k = 1/1(+a)^n$, where a = discount rate and n = period discount.

Schedule 2—Calculation of the Impairment Loss for Government R's Power Plant at the Beginning of 20X5

Beginning of 20X5	**Total CU(m)**
Historical cost	250.0
Accumulated depreciation (20X4)	(50.0)
Carrying amount	200.0
Carrying amount after impairment loss	121.1
Impairment loss	(78.9)

Reversal of an Impairment Loss

This Example relies on the data for Government R as presented in Example 2, with supplementary information provided in this Example. In this Example, tax effects are ignored.

Background

IG17. By 20X6 some competitors have closed down power plants and this has meant that the negative impact on the revenues of Government R has been less than projected at the end of 2004. This favorable change requires the government to re-estimate the recoverable amount of the power plant.

IG18. Calculations similar to those in Example 2 show that the recoverable amount of the power plant is now CU157.7 million.

Reversal of Impairment Loss

IG19. Government R compares the recoverable amount and the net carrying amount of the power plant and reverses part of the impairment loss previously recognized at Example 2.

Non-Cash-Generating Asset that Contributes to a Cash-Generating Unit

Background

IG20. A public hospital owns and operates a Magnetic Resonance Imaging (MRI) scanner that is primarily used by wards for non-fee paying patients. However, 20% of its usage is for treatment of fee-paying patients. The fee-paying patients are accommodated and treated in a separate building that includes wards, an operating theatre, and numerous pieces of capital equipment used solely for fee-paying patients. At December 31, 20X6, the carrying value of the building and capital equipment is CU30,000. It is not possible to estimate the recoverable amount of the building and the items of capital equipment on an individual basis. Therefore, the building and capital equipment are considered as a cash-generating unit (CGU). At January 1, 20X6 the MRI scanner had a carrying value of CU3,000. A depreciation expense of CU600 is recognized for the MRI scanner at December 31, 20X6. Because there have been significant technological advances in the field, the MRI scanner is tested for impairment at December 31, 20X6 and an impairment loss of CU400 is determined, so that the carrying value of the MRI scanner at December 31, 20X6 is CU2,000.

Determination of Recoverable Amount of Cash-Generating Unit

IG21. During the year there had been a significant reduction in the number of fee-paying patients at the hospital. The CGU is therefore tested for impairment. The recoverable amount of the CGU, based on its value in use, is assessed as CU27,400. 20% of the revised carrying value of the MRI scanner (CU400) is allocated to the carrying amount of the CGU before determining the impairment loss (CU3,000). The impairment loss is allocated to the building and capital equipment pro rata based on their carrying values. No further impairment loss is allocated to the MRI scanner, as an impairment loss has already been determined under the requirements of IPSAS 21, *Impairment of Non-Cash-Generating Assets*.

Inclusion of Recognized Liabilities in Calculation of Recoverable Amount of a Cash-Generating Unit

Background

IG22. A municipality operates a waste disposal site and is required to restore the site on completion of its operations. The cost of restoration includes the replacement of the topsoil, which must be removed before waste disposal operations commence. A provision for the costs to replace the top soil was recognized as soon as the top soil was removed. The amount provided was recognized as part of the cost of the site and is being depreciated over the site's useful life. The carrying amount of the provision for restoration costs is CU500, which is equal to the present value of the restoration costs.

Impairment Testing

IG23. The municipality is testing the site for impairment. The cash-generating unit is the site as a whole. The government has received various offers to buy the site at a price of around CU800. This price reflects the fact that the buyer will assume the obligation to restore the topsoil. Disposal costs for the site are negligible. The value in use of the site is approximately CU1,200, excluding restoration costs. The carrying amount of the waste disposal site is CU1,000.

IG24. The cash-generating unit's fair value less costs to sell is CU800. This amount includes restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs, and is estimated to be CU700 (CU1,200 minus CU500). The carrying amount of the cash-generating unit is CU500, which is the carrying amount of the site (CU1,000) minus the carrying amount of the provision for restoration costs (CU500). Therefore, the recoverable amount of the cash-generating unit exceeds its carrying amount.

Accounting Treatment of an Individual Asset in a Cash-Generating Unit dependent on whether Recoverable Amount can be Determined

Background

IG25. A holding tank at a water purification plant has suffered physical damage but is still working, although not as well as before it was damaged. The holding tank's fair value less costs to sell is less than its carrying amount. The holding tank does not generate independent cash inflows. The smallest identifiable group of assets that includes the holding tank and generates cash inflows that are largely independent of the cash inflows from other assets is the plant to which the holding tank belongs. The recoverable amount of the plant shows that the plant taken as a whole is not impaired.

Recoverable Amount of Holding Tank Cannot be Determined

IG26. Assumption 1: Budgets/forecasts approved by management reflect no commitment of management to replace the holding tank.

IG27. The recoverable amount of the holding tank alone cannot be estimated because the holding tank's value in use:

(a) May differ from its fair value less costs to sell; and

(b) Can be determined only for the cash-generating unit to which the holding tank belongs (the water purification plant).

The plant is not impaired. Therefore, no impairment loss is recognized for the holding tank. Nevertheless, the entity may need to reassess the depreciation period or the depreciation method for the holding tank. Perhaps a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the holding tank or the pattern in which economic benefits are expected to be consumed by the entity.

Recoverable Amount of Holding Tank Can be Determined

IG28. Assumption 2: Budgets/forecasts approved by management reflect a commitment of management to replace the holding tank and sell it in the near future. Cash flows from continuing use of the holding tank until its disposal are estimated to be negligible.

IG29. The holding tank's value in use can be estimated to be close to its fair value less costs to sell. Therefore, the recoverable amount of the holding tank can be determined, and no consideration is given to the cash-generating unit to which the holding tank belongs (i.e., the production line). Because the holding tank's fair value less costs to sell is below its carrying amount, an impairment loss is recognized for the holding tank.

Comparison with IAS 36

IPSAS 26, *Impairment of Cash-Generating Assets* deals with the impairment of cash-generating assets in the public sector, and includes an amendment made to IAS 36 (2004), *Impairment of Assets* as part of the *Improvements to IFRSs* issued in May 2008. The main differences between IPSAS 26 and IAS 36 are as follows: The main differences between IPSAS 26 and IAS 36 are as follows:

- IPSAS 26 does not apply to cash-generating assets carried at revalued amounts at the reporting date under the revaluation model in IPSAS 17, *Property, Plant, and Equipment*. IAS 36 does not exclude from its scope cash-generating property, plant, and equipment carried at revalued amounts at the reporting date.
- IPSAS 26 does not apply to intangible assets that are regularly revalued to fair value. IAS 36 does not exclude from its scope intangible assets that are regularly revalued to fair value.
- Goodwill is outside the scope of IPSAS 26. IAS 36 includes extensive requirements and guidance on the impairment of goodwill, the allocation of goodwill to cash-generating units, and testing cash-generating units with goodwill for impairment.
- IPSAS 26 defines cash-generating assets and includes additional commentary to distinguish cash-generating assets and non-cash-generating assets.
- The definition of a cash-generating unit in IPSAS 26 is modified from that in IAS 36.
- IPSAS 26 does not include a definition of corporate assets or requirements relating to such assets. IAS 36 includes a definition of corporate assets and requirements and guidance on their treatment.
- IPSAS 26 does not treat the fact that the carrying amount of the net assets of an entity is more than the entity’s market capitalization as indicating impairment. The fact that the carrying amount of the net assets is more than the entity’s market capitalization is treated by IAS 36 as part of the minimum set of indications of impairment.
- In IPSAS 26, a forced sale is not a reflection of fair value less costs to sell. In IAS 36, a forced sale is a reflection of fair value less costs to sell, if management is compelled to sell immediately.
- IPSAS 26 includes requirements and guidance on the treatment of non-cash-generating assets that contribute to cash-generating units as well as to non-cash-generating activities. IAS 36 does not deal with non-cash-generating assets that contribute to cash-generating units as well as to non-cash-generating activities.

- IPSAS 26 includes requirements and guidance dealing with the redesignation of assets from cash-generating to non-cash-generating and non-cash-generating to cash-generating. IPSAS 26 also requires entities to disclose the criteria developed to distinguish cash-generating assets from non-cash-generating assets. There are no equivalent requirements in IAS 36.
- IPSAS 26 uses different terminology, in certain instances, from IAS 36. The most significant examples are the use of the terms “revenue” and “statement of financial performance.” The equivalent terms in IAS 36 are “income” and “income statement.”

IPSAS 27—AGRICULTURE

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 41, *Agriculture* published by the International Accounting Standards Board (IASB). Extracts from IAS 41 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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IPSAS 27—AGRICULTURE

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 31, 2016.

IPSAS 27, *Agriculture* was issued in December 2009.

Since then, IPSAS 27 has been amended by the following IPSASs:

- IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* (issued January 2015)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 27

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
55	Deleted	IPSAS 33 January 2015
56A	New	IPSAS 33 January 2015
57	Amended	IPSAS 33 January 2015

December 2009

IPSAS 27—AGRICULTURE

CONTENTS

International Public Sector Accounting Standard 27, *Agriculture* is set out in paragraphs 1–57. All the paragraphs have equal authority. IPSAS 27 should be read in the context of its objective, the Basis for Conclusions, the *Preface to International Public Sector Accounting Standards,* and the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment and disclosures for agricultural activity.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard for the following when they relate to agricultural activity:**

   (a) **Biological assets; and**

   (b) **Agricultural produce at the point of harvest.**

3. This Standard does not apply to:

   (a) Land related to agricultural activity (see IPSAS 16, *Investment Property* and IPSAS 17, *Property, Plant, and Equipment*);

   (b) Intangible assets related to agricultural activity (see IPSAS 31, *Intangible Assets*); and

   (c) Biological assets held for the provision or supply of services.

4. Biological assets are used in many activities undertaken by public sector entities. When biological assets are used for research, education, transportation, entertainment, recreation, customs control or in any other activities that are not agricultural activities as defined in paragraph 9 of this Standard, those biological assets are not accounted for in accordance with this Standard. Where those biological assets meet the definition of an asset, other IPSASs should be considered in determining the appropriate accounting (e.g., IPSAS 12, *Inventories* and IPSAS 17).

5. This Standard is applied to agricultural produce, which is the harvested product of the entity's biological assets, only at the point of harvest. Thereafter, IPSAS 12, or another applicable Standard, is applied. Accordingly, this Standard does not deal with the processing of agricultural produce after harvest; for example, the processing of grapes into wine by a vintner who has grown the grapes. While such processing may be a logical and natural extension of agricultural activity, and the events taking place may bear some similarity to biological transformation, such processing is not included within the definition of agricultural activity in this Standard.

6. The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological assets	Agricultural produce	Products that are the result of processing after harvest
Sheep	Wool	Yarn, carpet
Trees in a plantation forest	Felled trees	Logs, lumber
Plants	Cotton	Thread, clothing
	Harvested cane	Sugar
Dairy cattle	Milk	Cheese
Pigs	Carcass	Sausages, cured hams
Bushes	Leaf	Tea, cured tobacco
Vines	Grapes	Wine
Fruit trees	Picked fruit	Processed fruit

7. **This Standard applies to all public sector entities other than Government Business Enterprises.**

8. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

Definitions

Agriculture-related Definitions

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

Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for:

- **Sale;**
- **Distribution at no charge or for a nominal charge; or**
- **Conversion into agricultural produce or into additional biological assets for sale or for distribution at no charge or for a nominal charge.**

Agricultural produce is the harvested product of the entity's biological assets.

A biological asset is a living animal or plant.

Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.

Costs to sell are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. Disposal may occur through sale or through distribution at no charge or for a nominal charge.

A group of biological assets is an aggregation of similar living animals or plants.

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

10. Agricultural activity covers a diverse range of activities; for example, raising livestock, forestry, annual or perennial cropping, cultivating orchards and plantations, floriculture, and aquaculture (including fish farming). Certain common features exist within this diversity:

    (a) *Capability to change*. Living animals and plants are capable of biological transformation;

    (b) *Management of change*. Management facilitates biological transformation by enhancing, or at least stabilizing, conditions necessary for the process to take place (for example, nutrient levels, moisture, temperature, fertility, and light). Such management distinguishes agricultural activity from other activities. For example, harvesting from unmanaged sources (such as ocean fishing and deforestation) is not agricultural activity; and

    (c) *Measurement of change*. The change in quality (for example, genetic merit, density, ripeness, fat cover, protein content, and fiber strength) or quantity (for example, progeny, weight, cubic meters, fiber length or diameter, and number of buds) brought about by biological transformation or harvest is measured and monitored as a routine management function.

11. Biological transformation results in the following types of outcomes:

    (a) Asset changes through (i) growth (an increase in quantity or improvement in quality of an animal or plant), (ii) degeneration (a decrease in the quantity or deterioration in quality of an animal or plant), or (iii) procreation (creation of additional living animals or plants); or

    (b) Production of agricultural produce such as latex, tea leaf, wool, and milk.

General Definitions

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

Recognition and Measurement

13. **An entity shall recognize a biological asset or agricultural produce when and only when:**

    (a) **The entity controls the asset as a result of past events;**

    (b) **It is probable that future economic benefits or service potential associated with the asset will flow to the entity; and**

    (c) **The fair value or cost of the asset can be measured reliably.**

14. The fair value of an asset is based on its present location and condition. As a result, for example, the fair value of cattle at a farm is the price for the cattle in the relevant market less the transport and other costs of getting the cattle either to that market or to the location where it will be distributed at no charge or for a nominal charge.

15. In agricultural activity, control may be evidenced by, for example, legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning. The future benefits or service potential are normally assessed by measuring the significant physical attributes.

16. **A biological asset shall be measured on initial recognition and at each reporting date at its fair value less costs to sell, except for the case described in paragraph 34 where the fair value cannot be measured reliably.**

17. **Where an entity acquires a biological asset through a non-exchange transaction, the biological asset is measured on initial recognition and at each reporting date in accordance with paragraph 16.**

18. **Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying IPSAS 12, or another applicable Standard.**

19. The determination of fair value for a biological asset or agricultural produce may be facilitated by grouping biological assets or agricultural produce according to significant attributes; for example, by age or quality. An entity selects the attributes corresponding to the attributes used in the market as a basis for pricing.

20. Entities often enter into contracts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in determining fair value, because fair value reflects the current market in which a willing buyer and seller would enter into a transaction. As a result, the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract. In some cases, a contract for the sale of a biological asset or agricultural produce in an exchange transaction may be an

onerous contract, as defined in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. IPSAS 19 applies to onerous contracts.

21. If an active market exists for a biological asset or agricultural produce in its present location and condition, the quoted price in that market is the appropriate basis for determining the fair value of that asset. If an entity has access to different active markets, the entity uses the most relevant one. For example, if an entity has access to two active markets, it would use the price existing in the market expected to be used.

22. If an active market does not exist, an entity uses one or more of the following, when available, in determining fair value:

    (a) The most recent market transaction price, provided that there has not been a significant change in economic circumstances between the date of that transaction and the reporting date;

    (b) Market prices for similar assets with adjustment to reflect differences; and

    (c) Sector benchmarks such as the value of an orchard expressed per export tray, bushel, or hectare, and the value of cattle expressed per kilogram of meat.

23. In some cases, the information sources listed in paragraph 22 may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An entity considers the reasons for those differences, in order to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.

24. In some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances, an entity uses the present value of expected net cash flows from the asset discounted at a current market-determined rate in determining fair value.

25. The objective of a calculation of the present value of expected net cash flows is to determine the fair value of a biological asset in its present location and condition. An entity considers this in determining an appropriate discount rate to be used and in estimating expected net cash flows. In determining the present value of expected net cash flows, an entity includes the net cash flows that market participants would expect the asset to generate in its most relevant market.

26. An entity does not include any cash flows for financing the assets, taxation, or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).

27. In agreeing an arm’s length transaction price, knowledgeable, willing buyers and sellers consider the possibility of variations in cash flows. It follows that fair value reflects the possibility of such variations. Accordingly, an entity

incorporates expectations about possible variations in cash flows into either the expected cash flows, or the discount rate, or some combination of the two. In determining a discount rate, an entity uses assumptions consistent with those used in estimating the expected cash flows, to avoid the effect of some assumptions being double-counted or ignored.

28. Cost may sometimes approximate fair value, particularly when:

  (a) Little biological transformation has taken place since initial cost incurrence (for example, for fruit tree seedlings planted immediately prior to reporting date); or

  (b) The impact of the biological transformation on price is not expected to be material (for example, for the initial growth in a 30-year pine plantation production cycle).

29. Biological assets are often physically attached to land (for example, trees in a plantation forest). There may be no separate market for biological assets that are attached to the land but an active market may exist for the combined assets, that is, for the biological assets, raw land, and land improvements, as a package. An entity may use information regarding the combined assets to determine fair value for the biological assets. For example, the fair value of raw land and land improvements may be deducted from the fair value of the combined assets to arrive at the fair value of biological assets.

Gains and Losses

30. **A gain or loss arising on initial recognition of a biological asset at fair value less costs to sell and from a change in fair value less costs to sell of a biological asset shall be included in surplus or deficit for the period in which it arises.**

31. A loss may arise on initial recognition of a biological asset, because costs to sell are deducted in determining fair value less costs to sell of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.

32. **A gain or loss arising on initial recognition of agricultural produce at fair value less costs to sell shall be included in surplus or deficit for the period in which it arises.**

33. A gain or loss may arise on initial recognition of agricultural produce as a result of harvesting.

Inability to Measure Fair Value Reliably

34. **There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which market-determined prices or values are not available, and for which alternative estimates of**

fair value are determined to be clearly unreliable. In such a case, that biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less costs to sell. Once a non-current biological asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale) in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations, it is presumed that fair value can be measured reliably.

35. The presumption in paragraph 34 can be rebutted only on initial recognition. An entity that has previously measured a biological asset at its fair value less costs to sell continues to measure the biological asset at its fair value less costs to sell until disposal.

36. In all cases, an entity measures agricultural produce at the point of harvest at its fair value less costs to sell. This Standard reflects the view that the fair value of agricultural produce at the point of harvest can always be measured reliably.

37. In determining cost, accumulated depreciation and accumulated impairment losses, an entity considers IPSAS 12, IPSAS 17, IPSAS 21, *Impairment of Non-Cash-Generating Assets*, and IPSAS 26, *Impairment of Cash-Generating Assets*.

Disclosure

General

38. **An entity shall disclose the aggregate gain or loss arising during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less costs to sell of biological assets.**

39. **An entity shall provide a description of biological assets that distinguishes between consumable and bearer biological assets and between biological assets held for sale and those held for distribution at no charge or for a nominal charge.**

40. Consumable biological assets are those that are held for harvest as agricultural produce or for sale or distribution at no charge or for a nominal charge as biological assets. Examples of consumable biological assets are animals and plants for one-time use, such as livestock intended for the production of meat, livestock held for sale, fish in farms, crops such as maize and wheat, and trees being grown for lumber. Bearer biological assets are those biological assets that are used repeatedly or continuously for more than one year in an agricultural activity. Bearer biological assets are not agricultural produce but,

rather, are self-regenerating. Examples of types of animals that are bearer biological assets include breeding stocks (including fish and poultry), livestock from which milk is produced, and sheep or other animals used for wool production. Examples of types of plants that are bearer biological assets include trees, vines and shrubs cultivated for fruits, nuts, sap, resin, bark and leaf products and trees from which firewood is harvested while the tree remains.

41. The disclosures required by paragraph 39 would take the form of a quantified description. The quantified description may be accompanied by a narrative description.

42. In making the disclosures required by paragraph 39, an entity is also encouraged to distinguish between mature and immature biological assets, as appropriate. These distinctions provide information that may be helpful in assessing the timing of future cash flows and service potential. An entity discloses the basis for making any such distinctions.

43. Mature biological assets are those that have attained harvestable specifications (for consumable biological assets) or are able to sustain regular harvests (for bearer biological assets).

44. **If not disclosed elsewhere in information published with the financial statements, an entity shall describe:**

    (a) **The nature of its activities involving each group of biological assets; and**

    (b) **Non-financial measures or estimates of the physical quantities of:**

        (i) **Each group of the entity's biological assets at the end of the period; and**

        (ii) **Output of agricultural produce during the period.**

45. **An entity shall disclose the methods and significant assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest and each group of biological assets.**

46. **An entity shall disclose the fair value less costs to sell of agricultural produce harvested during the period, determined at the point of harvest.**

47. **An entity shall disclose:**

    (a) **The existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities;**

    (b) **The nature and extent of restrictions on the entity's use or capacity to sell biological assets;**

(c) **The amount of commitments for the development or acquisition of biological assets; and**

(d) **Financial risk management strategies related to agricultural activity.**

48. **An entity shall present a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include:**

(a) **The gain or loss arising from changes in fair value less costs to sell, disclosed separately for bearer biological assets and consumable biological assets;**

(b) **Increases due to purchases;**

(c) **Increases due to assets acquired through a non-exchange transaction;**

(d) **Decreases attributable to sales and biological assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with the relevant international or national standard dealing with non-current assets held for sale and discontinued operations;**

(e) **Decreases due to distributions at no charge or for a nominal charge;**

(f) **Decreases due to harvest;**

(g) **Increases resulting from entity combinations;**

(h) **Net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity; and**

(i) **Other changes.**

49. The fair value less costs to sell of a biological asset can change due to both physical changes and price changes in the market. Separate disclosure of physical and price changes is useful in appraising current period performance and future prospects, particularly when there is a production cycle of more than one year. In such cases, an entity is encouraged to disclose, by group or otherwise, the amount of change in fair value less costs to sell included in surplus or deficit due to physical changes and due to price changes. This information is generally less useful when the production cycle is less than one year (for example, when raising chickens or growing cereal crops).

50. Biological transformation results in a number of types of physical change—growth, degeneration, production, and procreation, each of which is

observable and measurable. Each of those physical changes has a direct relationship to future economic benefits or service potential. A change in fair value of a biological asset due to harvesting is also a physical change.

51. Agricultural activity is often exposed to climatic, disease and other natural risks. If an event occurs that gives rise to a material item of revenue or expense, the nature and amount of that item are disclosed in accordance with IPSAS 1. Examples of such an event include an outbreak of a virulent disease, a flood, a severe drought or frost, and a plague of insects.

Additional Disclosures for Biological Assets Where Fair Value Cannot Be Measured Reliably

52. **If an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 34) at the end of the period, the entity shall disclose for such biological assets:**

    (a) **A description of the biological assets;**

    (b) **An explanation of why fair value cannot be measured reliably;**

    (c) **If possible, the range of estimates within which fair value is highly likely to lie;**

    (d) **The depreciation method used;**

    (e) **The useful lives or the depreciation rates used; and**

    (f) **The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.**

53. **If, during the current period, an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 34), an entity shall disclose any gain or loss recognized on disposal of such biological assets and the reconciliation required by paragraph 48 shall disclose amounts related to such biological assets separately. In addition, the reconciliation shall include the following amounts included in surplus or deficit related to those biological assets:**

    (a) **Impairment losses;**

    (b) **Reversals of impairment losses; and**

    (c) **Depreciation.**

54. **If the fair value of biological assets previously measured at their cost less any accumulated depreciation and any accumulated impairment losses becomes reliably measurable during the current period, an entity shall disclose for those biological assets:**

(a) **A description of the biological assets;**

(b) **An explanation of why fair value has become reliably measurable; and**

(c) **The effect of the change.**

Transitional Provision

55. [Deleted]

Effective Date

56. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after April 1, 2011. Earlier application is encouraged. If an entity applies this Standard for a period beginning before April 1, 2011, it shall disclose that fact.**

56A. **Paragraphs 55 and 57 were amended by IPSAS 33, *First-time Adoption of Accrual Basis International Public Sector Accounting Standards (IPSASs)* issued in January 2015. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2017. Earlier application is permitted. If an entity applies IPSAS 33 for a period beginning before January 1, 2017, the amendments shall also be applied for that earlier period.**

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

Appendix

Amendments to Other IPSASs

The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

IPSAS 9*, Revenue from Exchange Transactions*

Paragraph 10 is amended as follows:

10(e) Arising from ~~natural increase in herds, and agriculture and forest products at~~ initial recognition, and from changes in the fair value of, biological assets related to agricultural activity (see IPSAS 27 , *Agriculture*); ~~and~~

10(eA) Arising from initial recognition of agricultural produce (see IPSAS 27); and

IPSAS 12*, Inventories*

Paragraph 2(c) is amended as follows:

2(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~~ IPSAS 27, *Agriculture*); and**

Paragraph 29 is amended as follows:

29. **In accordance with ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27 inventories comprising agricultural produce that an entity has harvested from its biological assets ~~may~~ shall be measured on initial recognition at their fair value less ~~estimated point-of sale~~ costs to sell at the point of harvest. This is the cost of the inventories at that date for application of this Standard.**

Paragraph 51A is inserted after paragraph 51 as follows:

51A. **IPSAS 27 amended paragraph 29. An entity shall apply that amendment for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies IPSAS 27 for a period beginning before April 1, 2011, the amendment shall also be applied for that earlier period.**

IPSAS 13, *Leases*

Paragraphs 2(c) and 2(d) are amended as follows:

2(c) **Biological assets held by lessees under finance leases (see ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27, *Agriculture*); or**

2(d) **Biological assets provided by lessors under operating leases (see ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27).**

IPSAS 16, *Investment Property*

Paragraph 6 is amended as follows:

6(a) Biological assets related to agricultural activity (see ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27, *Agriculture*); and

IPSAS 17, *Property, Plant, and Equipment*

Paragraph 6 is amended as follows:

6(a) Biological assets related to agricultural activity (see ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27, *Agriculture*); ~~and~~ or

IPSAS 26, *Impairment of Cash-Generating Assets*

Paragraph 2 is amended as follows:

2(j) **Biological assets related to agricultural activity that are measured at fair value less ~~estimated point-of-sale~~ costs to sell (see ~~the relevant international or national accounting standard dealing with agricultural assets~~ IPSAS 27, *Agriculture*);**

Paragraph 8 is amended as follows:

8. **… In addition, this Standard does not apply to biological assets related to agricultural activity that are measured at fair value less ~~certain point-of-sale~~ costs to sell and non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value less costs to sell. IPSAS 27, *Agriculture*, dealing with biological assets related to agricultural activity, and ~~T~~the relevant international or national accounting standard~~s~~ dealing with non-current assets (or disposal groups) classified as held for sale, contain measurement requirements.**

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 27.

Introduction

BC1. The IPSASB's IFRSs Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to develop accrual-based IPSASs that are convergent 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.

Biological Assets Held for the Provision or Supply of Services

BC3. The IPSASB acknowledged that in the public sector biological assets are often held for the provision or supply of services. Examples of such biological assets include horses and dogs used for policing purposes and plants and trees in parks and gardens operated for recreational purposes. The IPSASB concluded that such biological assets are not held for use in an agricultural activity because they are not routinely managed for the purpose of measuring and monitoring the change in quality or quantity brought about by biological transformation or harvest, as described in paragraph 10. In order to clarify that such biological assets are not dealt with in this Standard the IPSASB decided to include a scope exclusion in paragraph 3(c) stating that the Standard does not apply to biological assets held for the provision or supply of services. Paragraph 4 provides examples of such scope exclusions.

Definition of Agricultural Activity

BC4. In certain jurisdictions biological assets that are part of agricultural activity may be sold or distributed to other public sector entities, non-governmental organizations or other entities at no charge or for a nominal charge. While IAS 41, *Agriculture*, from which this Standard is drawn, deals with commercial agricultural activity, the IPSASB concluded that biological assets held for distribution at no charge or for a nominal charge should be within the definition of agricultural activity, because such transactions are common in the public sector. The IPSASB therefore modified the definition from that in IAS 41 to include references to biological assets held for distribution at no charge or for a nominal charge.

Government Grants

BC5. IAS 41 specifies requirements and guidance for accounting for government grants related to biological assets that differ from the requirements in IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*. IPSAS 27 does not include requirements and guidance for government grants, because IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* provides requirements and guidance related to government grants in non-exchange transactions. The IPSASB did not consider that accounting for government grants related to biological assets should vary from the requirements of IPSAS 23.

Biological Assets and Agricultural Assets Acquired through a Non-Exchange Transaction

BC6. An entity may acquire a biological asset or agricultural produce in a non-exchange transaction. In accordance with this Standard, these assets would be measured at fair value less costs to sell. IPSAS 23 prescribes that assets acquired through a non-exchange transaction should be measured initially at fair value as at the date of acquisition. As a result of the different measurement requirements, the IPSASB considered the appropriate measurement basis for biological assets acquired in a non-exchange transaction.

BC7. The IPSASB debated various approaches to measuring biological assets and agricultural produce acquired through a non-exchange transaction. In particular, it considered the following three approaches:

(a) Approach 1: Measure all biological assets and agricultural produce acquired in a non-exchange transaction using IPSAS 23 (i.e., exclude all biological assets and agricultural produce acquired in a non-exchange transaction from the measurement requirements of this Standard);

(b) Approach 2: Measure all biological assets and agricultural produce acquired in a non-exchange transaction using this Standard (i.e., exclude all biological assets and agricultural produce from the measurement requirements of IPSAS 23); and

(c) Approach 3: Use both IPSAS 23 and this Standard to measure biological assets and agricultural produce acquired in a non-exchange transaction.

BC8. The IPSASB rejected approach 1 because biological assets and agricultural produce acquired in exchange and non-exchange transactions would be measured differently. The IPSASB agreed that there is no reason to measure biological assets and agricultural produce acquired in a non-exchange transaction differently from those acquired in an exchange transaction because the assets are the same.

BC9. In analyzing approach 3, the IPSASB considered the requirements of IPSAS 23 in relation to the measurement of other types of assets. IPSAS 23.13 states that: "...If a reporting entity is required to pay delivery and installation costs in relation to the transfer of an item of plant to it from another entity, those costs are recognized separately from revenue arising from the transfer of the item of plant. Delivery and installation costs are included in the amount recognized as an asset, in accordance with IPSAS 17." This implies that for other assets, an entity considers the measurement requirements of other IPSASs as well as IPSAS 23 in initially measuring assets acquired through a non-exchange transaction.

BC10. An additional attribute relevant to the measurement of biological assets is costs to sell. The IPSASB therefore concluded that in accordance with approach 3, an entity considers the requirements of both IPSAS 23 and this Standard in measuring biological assets and agricultural produce acquired in a non-exchange transaction at fair value less costs to sell at their initial recognition. The IPSASB noted that this is the same outcome as under approach 2.

Biological Assets and Agricultural Produce to be Distributed at No Charge or for a Nominal Charge

BC11. IAS 41 addresses only biological assets and agricultural produce that will be sold. In the public sector, such assets may be managed with the objective of distributing them at no charge or for a nominal charge. Some respondents to Exposure Draft 36, *Agriculture* expressed a view that a distinction should be made between the recognition and measurement of biological assets held for sale in an exchange transaction, and biological assets held for distribution at no charge or for a nominal charge. The principle was established in IPSAS 12, *Inventories*, that inventories held for distribution at no charge or for a nominal charge should be measured at the lower of cost and current replacement cost. Cost is not an available option in this Standard unless the exception in paragraph 34 applies. Current replacement cost is defined as the cost an entity would incur to acquire the asset at the reporting date, which is an approximation of fair value less costs to sell. Accordingly, the approach in Exposure Draft 36 was not changed.

BC12. Some respondents to the Exposure Draft also questioned whether gains and losses arising from use of fair value measurement should be reported in the statement of financial performance during the transformation process. The IPSASB is of the view that the gains and losses arising from fair value measurement should be reported in the statement of financial performance because such reporting provides useful accountability information during the biological transformation process. Entities may decide to make additional disclosures to explain the impact of these reported fair value changes.

Disclosure

BC13. The IPSASB considered whether any further disclosures were justified to address public sector specific issues and added disclosure requirements to:

(a) Distinguish between consumable and bearer biological assets. This distinction is necessary because the Government Finance Statistics (GFS) Manual 2001 (GFSM 2001) classifies consumable assets as inventory, while this Standard classifies them as biological assets. The distinction allows for a better reconciliation between an entity's financial statements prepared under IPSASs and statistical measures.

(b) Distinguish between biological assets held for sale and those held for distribution at no charge or for a nominal charge. The IPSASB believes this distinction is necessary to permit users to determine the unrealized gains and losses on biological assets held for distribution at no charge or for a nominal charge.

(c) Show biological assets acquired through non-exchange transactions and biological assets held for distribution at no charge or for a nominal charge in its reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. This disclosure is required to provide appropriate information about non-exchange transactions, which are included in the scope of this Standard.

(d) Disclose separately the changes in fair value less costs to sell as a result of non-exchange transactions for biological assets held for sale and for biological assets held for distribution at no charge or for a nominal charge. It is important that information is provided on the amount of gains and losses attributable to biological assets intended for distribution at no charge or for a nominal charge to assist users of financial statements in assessing the cost of government programs.

(e) Describe the nature and extent of restrictions imposed on the entity's use or capacity to sell biological assets, such as the total and restricted amounts of such assets. The IPSASB is of the view that such disclosure provides useful information about the entity's ability to sell agricultural produce at fair value, and thus about its measurement.

Transitional Provisions

BC14. IAS 41 does not contain transitional provisions for first-time adoption of the accrual basis of accounting. When issued, this Standard contained such provisions to assist entities in applying this Standard when first adopting the accrual basis of accounting. These provisions have since been replaced by the guidance in IPSAS 33, *First-time Adoption of Accrual Basis IPSASs*.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 27.

Extracts from statements of financial performance and statements of financial position are provided to show the effects of the transactions described below. These extracts do not necessarily conform to all the disclosure and presentation requirements of other Standards.

The first example illustrates how the disclosure requirements of this Standard might be put into practice for a dairy farming entity. This Standard encourages the separation of the change in fair value less costs to sell of an entity's biological assets into physical change and price change. That separation is reflected in the first example. The second example illustrates how to separate physical change and price change.

Disclosure Requirements

Statement of Financial Position

Entity XYZ	**Notes**	**December 31, 20X8**	**December 31, 20X7**
		Currency Unit (CU)	**CU**
ASSETS			
Current assets			
Cash		10,000	10,000
Receivables		88,000	65,000
Inventories		82,950	70,650
Total current assets		**180,950**	**145,650**
Non-current assets			
Bearer biological assets			
Dairy livestock – immature[1]		52,060	47,730
Dairy livestock – mature[1]		372,990	411,840
Subtotal – bearer biological assets	3	425,050	459,570
Property, plant and equipment		1,462,650	1,409,800
Total non-current assets		**1,887,700**	**1,869,370**
Total assets		**2,068,650**	**2,015,020**
LIABILITIES			
Current liabilities			
Payables		122,628	150,020
Total current liabilities		**122,628**	**150,020**
NET ASSETS/EQUITY			
Contributed capital		1,000,000	1,000,000
Accumulated surplus		946,022	865,000
Total net assets/equity		**1,946,022**	**1,865,000**
Total net assets/equity and liabilities		**2,068,650**	**2,015,020**

[1] An entity is required to provide a description of biological assets that distinguishes between consumable and bearer biological assets and between those held for sale and those held for distribution at no charge or for a nominal charge. Such disclosures would take the form of a quantified description that may be accompanied by a narrative description. An entity is also encouraged, but not required, to distinguish between mature and immature biological assets, as appropriate. An entity discloses the basis for making any such distinctions. This example shows the disclosure of bearer biological assets on the face of the statement of financial position. Information to meet other disclosure requirements is disclosed in the notes to the financial statements, as permitted.

Statement of Financial Performance

Entity XYZ	Notes	CU Year ended December 31, 20X8
Fair value of milk produced		518,240
Gains arising from changes in fair value less costs to sell of dairy livestock held for sale	3	39,930
		558,170
Inventories used		(137,523)
Staff costs		(127,283)
Depreciation expense		(15,250)
Other operating expenses		(197,092)
		(477,148)
Surplus for the period		**81,022**

Statement of Changes in Net Assets/Equity

	Year ended December 31, 20X8 CU	CU	CU
	Contributed Capital	**Accumulated Surplus**	**Total**
Balance at January 1, 20X8	1,000,000	865,000	**1,865,000**
Surplus for the period	-	81,022	**81,022**
Balance at December 31, 20X8	**1,000,000**	**946,022**	**1,946,022**

Cash Flow Statement[2]

Entity XYZ	**Year ended December 31, 20X8**
	CU
Cash flows from operating activities	
Cash receipts from sales of milk	498,027
Cash receipts from sales of livestock	97,913
Cash paid for supplies and to employees	(504,025)
Cash paid for purchases of livestock	(23,815)
Net cash from operating activities	**68,100**
Cash flows from investing activities	
Purchase of property, plant and equipment	(68,100)
Net cash used in investing activities	**(68,100)**
Net increase in cash	**0**
Cash at beginning of the year	**10,000**
Cash at end of the year	**10,000**

Notes

1. Operations and Principal Activities

Entity XYZ ("the Entity") is engaged in milk production. At December 31, 20X8, the Entity held 419 cows able to produce milk (mature bearer assets) and 137 heifers being raised to produce milk in the future (immature bearer assets). The Entity produced 157,584kg of milk with a fair value less costs to sell of CU518,240 (the fair value of this agricultural produce is determined at the time of milking) in the year ended December 31, 20X8. The Entity does not own any consumable biological assets.

2. Accounting Policies

Livestock and Milk

Livestock are measured at their fair value less costs to sell. The fair value of livestock is determined based on market prices of livestock of similar age, breed, and genetic merit. Milk is initially measured at its fair value less costs to sell at the time of milking. The fair value of milk is determined based on market prices in the local area.

2 This statement of cash flows reports cash flows from operating activities using the direct method. IPSAS 2, "Cash Flow Statements" requires that an entity reports cash flows from operating activities using either the direct method or the indirect method. IPSAS 2 encourages use of the direct method.

3. Biological Assets

Reconciliation of Carrying Amounts of Dairy Livestock	20X8 CU
Carrying amount at January 1, 20X8	**459,570**
Increases due to purchases	26,250
Gain arising from changes in fair value less costs to sell attributable to physical changes[3]	15,350
Gain arising from changes in fair value less costs to sell attributable to price changes[4]	24,580
Decreases due to sales	(100,700)
Carrying amount at December 31, 20X8	**425,050**

4. Financial Risk Management Strategies

The Entity is exposed to financial risks arising from changes in milk prices. The Entity does not anticipate that milk prices will decline significantly in the foreseeable future and, therefore, has not entered into derivative or other contracts to manage the risk of a decline in milk prices. The Entity reviews its outlook for milk prices regularly in considering the need for active financial risk management.

Physical Change and Price Change

The following example illustrates how to separate physical change and price change. Separating the change in fair value less costs to sell between the portion attributable to physical changes and the portion attributable to price changes is encouraged but not required by this Standard.

A herd of ten 2 year old animals was held at January 1, 20X8. One animal aged 2.5 years was purchased on July 1, 20X8 for CU108, and one animal was born on July 1, 20X8. No animals were sold or disposed of during the period. Per-unit fair values less costs to sell were as follows:

	CU	CU
2 year old animal at January 1, 20X8	100	
Newborn animal at July 1, 20X8	70	
2.5 year old animal at July 1, 20X8	108	
Newborn animal at December 31, 20X8	72	
0.5 year old animal at December 31, 20X8	80	
2 year old animal at December 31, 20X8	105	
2.5 year old animal at December 31, 20X8	111	
3 year old animal at December 31, 20X8	120	

3 Separating the increase in fair value less costs to sell between the portion attributable to physical changes and the portion attributable to price changes is encouraged but not required by this Standard.

4 See Footnote 3.

Fair value less costs to sell of herd at January 1, 20X8 (10 x 100)		1,000
Purchase on July 1, 20X8 (1 x 108)		108
Increase in fair value less costs to sell due to price change		
10 × (105 – 100)	50	
1 × (111 – 108)	3	
1 × (72 – 70)	2	55
Increase in fair value less costs to sell due to physical change:		
10 × (120 – 105)	150	
1 × (120 – 111)	9	
1 × (80 – 72)	8	
1 × 70	70	237
Fair value less costs to sell of herd at December 31, 20X8		
11 × 120	1,320	
1 × 80	80	1,400

Comparison with IAS 41

IPSAS 27, *Agriculture* is drawn primarily from IAS 41, *Agriculture* (2001), as amended up to December 31, 2008. The main differences between IPSAS 27 and IAS 41 are as follows:

- The definition of "agricultural activity" includes transactions for the distribution of biological assets at no charge or for a nominal charge. IAS 41 does not deal with such transactions.
- The scope section clarifies that biological assets held for the provision or supply of services are not addressed in this Standard. IAS 41 does not include such a clarification.
- IAS 41 includes requirements for government grants relating to biological assets measured at fair value less costs to sell. IPSAS 27 does not include requirements and guidance for government grants, because IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* provides requirements and guidance related to government grants in non-exchange transactions.
- IPSAS 27 contains requirements for the measurement at initial recognition, and at each reporting date, of biological assets acquired through a non-exchange transaction.
- This Standard contains an additional disclosure requirement for biological assets for which the entity's use or capacity to sell are subject to restrictions.
- This Standard contains a requirement to distinguish between consumable and bearer biological assets and between biological assets held for sale and those held for distribution at no charge or for a nominal charge. Such disclosures would take the form of a quantified description that may be accompanied by a narrative description. IAS 41 encourages, but does not require, entities to provide a quantified description of each group of biological assets, distinguishing between consumable and bearer biological assets, or between mature and immature biological assets, as appropriate.
- This Standard contains transitional provisions on the first-time adoption of accrual accounting. IAS 41 does not include such transitional provisions.
- IPSAS 27 uses different terminology, in certain instances, from IAS 41. The most significant examples are the use of the terms future economic benefits and service potential, surplus or deficit, and statement of financial performance in IPSAS 27. The equivalent terms in IAS 41 are future economic benefits, profit or loss, and statement of comprehensive income.

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