

**Exposure Draft of Proposed
IMPROVEMENTS TO
INTERNATIONAL
ACCOUNTING STANDARDS**

Comments to be received by 16 September 2002

This Exposure Draft is published by the International Accounting Standards Board (IASB) for comment only. The recommendations in the draft may be modified in the light of the comments received before being issued in the form of amended International Accounting Standards.

Comments should be submitted in writing so as to be received by
16 September 2002.

All replies will be put on public record unless confidentiality is requested by the commentator. If commentators respond by fax or email, it would be helpful if they could also send a hard copy of their response by post. Comments should preferably be sent by email to: **CommentLetters@iasb.org.uk** or addressed to:

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Exposure Draft of Proposed Improvements to International Accounting Standards

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Proposed Improvements to International Accounting Standards

Invitation to Comment

Invitation to Comment

This Exposure Draft proposes improvements to twelve Standards. The Board invites comments on all the changes proposed in the Exposure Draft, and would particularly welcome answers to the questions set out in the 'Invitation to Comment' section at the front of each Standard (except for IAS 10). The Board is not requesting comments on unchanged aspects of these Standards. Nevertheless, respondents are, as always, free to comment on any aspect of a proposed Standard. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, where applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than 16 September 2002.

Until revised Standards become effective, the requirements of the current version of the relevant Standard remain in force.

Background

1. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards and to make other improvements to them. The Board also decided to deal with some convergence issues and to merge any related SIC consensus into the Standard whenever the revision of a Standard presented a suitable opportunity.
2. The Board received a large number of suggestions on matters that should be addressed in its Improvements project. The initial list of issues to be considered came from sources including the International Organization of Securities Commissions (IOSCO), the European Commission, comparisons of IASs and national standards undertaken by various organisations, national standard-setters, accounting firms and the Standing Interpretations Committee (SIC).

Standards addressed

3. The following twelve Standards have been addressed in the Improvements project:
 - IAS 1, Presentation of Financial Statements
 - IAS 2, Inventories
 - IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies
 - IAS 10, Events After the Balance Sheet Date
 - IAS 16, Property, Plant and Equipment
 - IAS 17, Leases
 - IAS 21, The Effects of Changes in Foreign Exchange Rates
 - IAS 23, Borrowing Costs
 - IAS 24, Related Party Disclosures
 - IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries
 - IAS 28, Accounting for Investments in Associates
 - IAS 33, Earnings Per Share
4. The consideration of IAS 17, Leases, led to a proposal for a limited revision to IAS 40, Investment Property. The Board also decided to withdraw IAS 15, Information Reflecting the Effect of Changing Prices.
5. In addition, the Board considered all the allowed accounting alternatives, generally described as a Benchmark and Allowed Alternative, in the above Standards, except for the choice between cost and revaluation for measurement of assets subsequent to initial recognition in IAS 16, Property, Plant and Equipment.
6. The Board considered whether to eliminate the choice in IAS 23, Borrowing Costs, either to capitalise borrowing costs that meet certain conditions or to report all borrowing costs as an expense in the period in which they are incurred. It also noted some support for a third

approach of capitalising an asset-specific total cost of capital (debt and equity). The Board decided that this issue is best addressed in the context of a wider project on how to measure an asset on initial recognition. The Board intends to undertake such a project, agenda priorities permitting. For this reason, the Board does not propose to eliminate that choice in the Improvements project.

7. The Board also agreed to exclude those issues on IAS 1, Presentation of Financial Statements, being addressed in its Reporting Financial Performance project. In addition, in the light of the Board's envisaged project on leases, only two issues were addressed regarding IAS 17, Leases.
8. IAS 32, Financial Instruments: Disclosure and Presentation, and IAS 39, Financial Instruments: Recognition and Measurement, are together the subject of a separate improvements project. An Exposure Draft on proposed improvements to these two Standards is expected to be published for comment shortly after this Exposure Draft.
9. Standards for which the Board has a current project to address the subject were not addressed in the Improvements project. For example, the Board concluded that it is not appropriate to propose improvements to IAS 22, Business Combinations, while it is considering more fundamental changes to that Standard. Matters that were suggested for consideration as improvements to IAS 22 are being considered as part of the main project.

Presentation of the document

10. This Exposure Draft presents for each of eleven of the Standards revised in the Improvements project the following:
 - an Invitation to Comment
 - a Summary of Main Changes
 - Revised Text
 - a Basis for Conclusions.

For IAS 10, Events After the Balance Sheet Date, there is no Invitation to Comment or Basis for Conclusions in view of the limited revisions proposed.

11. As explained in paragraph 17 below, if a Board member dissents from the conclusions in an Exposure Draft, that member's alternative view is set out in an appendix after the Basis for Conclusions. Alternative views are presented in this Exposure Draft after the Basis for Conclusions for IAS 1, Presentation of Financial Statements and IAS 24, Related Party Disclosures.
12. Consequential amendments to Standards not fully exposed or not addressed in the Improvements project and to SIC Interpretations are proposed at the end of the Exposure Draft.

Invitation to Comment

13. Questions have been limited to major issues, but the Board would also welcome comments on other changes proposed.

Summary of Main Changes

14. This section summarises the Board's main proposals for changes to the Standard. Where appropriate, reference also is made to the potential elimination of choices or other issues that the Board addressed and on which it concluded that it would not propose any changes at this time. Minor matters and editorial changes are not mentioned.

Revised text

15. The presentation of the revised text varies depending on the extent of the proposed changes:
 - (a) a marked-up copy of the full text of the Standard is presented for:
 - IAS 2, Inventories
 - IAS 16, Property, Plant and Equipment
 - IAS 27, Consolidated Financial Statements and Accounting for Investments in Subsidiaries
 - IAS 28, Accounting for Investments in Associates.

- (b) when the changes proposed are pervasive, only a clean copy of the full revised text of the Standard is presented:
- IAS 1, Presentation of Financial Statements
 - IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies
 - IAS 21, The Effects of Changes in Foreign Exchange Rates
 - IAS 24, Related Party Disclosures
 - IAS 33, Earnings Per Share.
- (c) when the proposed changes would result in the revision of a limited number of paragraphs, only the relevant paragraphs are presented:
- IAS 10, Events After the Balance Sheet Date
 - IAS 17, Leases
 - IAS 40, Investment Property.

Appendices to the Standards are not presented, except for the Appendices to IAS 33, Earnings Per Share, which are new or substantially revised.

Basis for Conclusions

16. This section presents the basis for the Board's conclusions on major issues. The Basis for Conclusions presents views considered by the Board, including some supported by a minority of Board members who, nonetheless, support the publication of the Exposure Draft for an individual Standard.

Alternative views

17. The alternative views included in an appendix after the Basis for Conclusions reflect the views of Board members who voted against the publication of the Exposure Draft of that individual Standard. Those Board members concluded that the proposed revised text for that Standard, taken as a whole, should not be issued in its present form. The IASB does not allow partial dissents.

18. Board members' views (including the views of Board members who supported the publication of the Exposure Draft of an individual Standard) may change as a result of comments received in the exposure process. Alternative views are not attributed to individual Board members.

Consequential amendments to other Standards

19. Consequential amendments to Standards not addressed in the Improvements project and to SIC Interpretations are presented at the end of the Exposure Draft. Consequential amendments to Appendices and Bases for Conclusions are not presented.

Style

20. The Board decided that Standards revised in the Improvements project should be issued as revised International Accounting Standards (IASs). Therefore, most of the style changes the Board has agreed to make for new Standards—International Financial Reporting Standards (IFRSs)—have not been reflected in the revised text. The Board has published an Exposure Draft of a proposed Preface to International Financial Reporting Standards (IFRSs) that sets out certain proposed style changes.
21. However, this document reflects the Board's decision to change certain terminology in existing Standards. Accordingly, the word 'shall' is used instead of 'should' and 'entity' is used instead of 'enterprise'. By replacing 'should' with 'shall', the Board does not intend to change the requirements in the Standards, but to clarify that it interprets 'should' as meaning 'shall'. By replacing 'enterprise' with 'entity', a more neutral term, the Board intends to reflect its objective that Standards are used by all profit-oriented entities preparing general purpose financial statements.

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

Presentation of Financial Statements

International Accounting Standard IAS 1 **(revised 200X)**

Presentation of Financial Statements

Invitation to Comment

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

Question 1

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

Question 2

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

Question 3

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

Question 4

Do you agree that:

- (a) a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date, even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62)?
- (b) if a lender was entitled to demand immediate repayment of a loan because the entity breached a condition of its loan agreement, but agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender

cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

- (i) the entity rectifies the breach within the period of grace; or
- (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 63 and 64)?

Question 5

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

Question 6

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

Summary of Main Changes

The main changes proposed are:

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

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

- to amend paragraph 65 to specify that a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach (see proposed paragraph 62). However, proposed paragraph 63 states that if the lender has agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during that time the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:
 - the entity rectifies the breach within the period of grace; or
 - when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified.
- to extend paragraphs 66 and 75 to include all requirements currently set out in other Standards for the presentation of particular line items on the face of the balance sheet and income statement (see proposed paragraphs 65 and 76). Consequently, those requirements would be removed from other Standards.
- to transfer to this Standard from IAS 8 the section that sets out the presentation requirements for the net profit or loss for the period (IAS 8, paragraphs 7-10: see proposed paragraphs 73-75).
- to remove requirements for the following disclosures:
 - the results of operating activities, as a line item on the face of the income statement (paragraph 75(b)). 'Operating activities' are not defined in IAS 1.

- extraordinary items, as a line item on the face of the income statement (paragraph 75(g)). Proposed paragraphs 78 and 79 are added to specify that disclosure of 'extraordinary items' is prohibited in financial statements.
- an entity's country of incorporation and the address of its registered office (paragraph 102(a)).
- the number of an entity's employees (paragraph 102(d)).
- to add proposed paragraphs 108 and 109, to require disclosure of the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements.
- to add proposed paragraphs 110-115, to require disclosure of key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year.

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

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International Accounting Standard IAS 1 (revised 200X)

Presentation of Financial Statements

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

Objective

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

Scope

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

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

Purpose of Financial Statements

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

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

Components of Financial Statements

6. *A complete set of financial statements includes the following components:*
 - (a) *a balance sheet;*
 - (b) *an income statement;*
 - (c) *a statement of changes in equity showing either:*
 - (i) *all changes in equity, or*
 - (ii) *changes in equity other than those arising from capital transactions with owners and distributions to owners;*
 - (d) *a cash flow statement; and*
 - (e) *a summary of significant accounting policies and other explanatory notes.*
7. Many entities present, outside the financial statements, a financial review by management that describes and explains the main features of the entity's financial performance and financial position and the principal uncertainties it faces. Such a report may include a review of:
 - (a) the main factors and influences determining financial performance, including changes in the environment in which the entity operates, the entity's response to those changes and their effect, and the entity's policy for investment to maintain and enhance financial performance, including its dividend policy;
 - (b) the entity's sources of funding, its policy on gearing and its risk management policies; and
 - (c) the resources of the entity whose value is not recognised in the balance sheet under International Financial Reporting Standards.
8. Many entities present, outside the financial statements, additional statements such as environmental reports and value added statements, particularly in industries where environmental factors are significant and when employees are regarded as an important user group.
9. The reports and statements described in paragraphs 7 and 8 are outside the scope of International Financial Reporting Standards.

Overall Considerations

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

- 10. Financial statements shall present fairly the financial position, financial performance and cash flows of an entity (that is, represent faithfully the effects of transactions and other events in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework for the Preparation and Presentation of Financial Statements). The application of International Financial Reporting Standards and Interpretations of those Standards, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation.*
- 11. An entity whose financial statements comply with International Financial Reporting Standards and Interpretations of those Standards shall disclose that fact. Financial statements shall not be described as complying with International Financial Reporting Standards and Interpretations of those Standards unless they comply with all the requirements of each applicable Standard and Interpretation.*
12. In virtually all circumstances, a fair presentation is achieved by compliance with applicable International Financial Reporting Standards and Interpretations of those Standards. A fair presentation requires:
 - (a) selecting and applying accounting policies in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors. IAS 8 specifies a hierarchy of authoritative guidance that management considers in the absence of a Standard or an Interpretation specifically applying to an item;
 - (b) presenting information, including accounting policies, in a manner that provides relevant, reliable, comparable and understandable information; and
 - (c) providing additional disclosures when the particular requirements in International Financial Reporting Standards and

Interpretations of those Standards are insufficient to enable users to understand the impact of particular transactions or other events on the entity's financial position and financial performance.

13. *In the extremely rare circumstances in which management concludes that compliance with a requirement in an International Financial Reporting Standard or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework, the entity shall depart from that requirement in the manner set out in paragraph 14 if the relevant regulatory framework requires or otherwise does not prohibit such a departure.*
14. *When an entity departs from a requirement of an International Financial Reporting Standard or an Interpretation of a Standard under paragraph 13, it shall disclose:*
 - (a) *that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows;*
 - (b) *that it has complied with applicable International Financial Reporting Standards and Interpretations of those Standards, except that it has departed from a requirement of a Standard or an Interpretation to achieve a fair presentation;*
 - (c) *the Standard or Interpretation from which the entity has departed, the nature of the departure, including the treatment that the Standard or Interpretation would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in the Framework, and the treatment adopted; and*
 - (d) *for each period presented, the financial impact of the departure on each item in the financial statements that would have been reported in complying with the requirement.*
15. *In the extremely rare circumstances in which management concludes that compliance with a requirement in an International Financial Reporting Standard or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework, and the relevant regulatory framework prohibits departure from the requirement, the*

entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:

- (a) the Standard or Interpretation requiring the entity to report information concluded to be misleading, the nature of the requirement, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in the Framework; and*
 - (b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.*
16. For the purposes of paragraphs 13-15, an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions or other events that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to affect adversely economic decisions made by users of financial statements. When assessing whether complying with a specific requirement in an International Financial Reporting Standard or an Interpretation of a Standard would be so misleading that it would conflict with the objective of financial statements set out in the Framework, consideration is given to:
- (a) why the objective of financial statements is not achieved in the particular circumstances; and
 - (b) the way in which the entity's circumstances differ from those of other entities that comply with the requirement. There is a rebuttable presumption that if other entities in similar circumstances comply with the requirement, the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework.
17. *When, in accordance with specific provisions in that Standard, an International Financial Reporting Standard is applied before its effective date, that fact shall be disclosed.*

Going Concern

18. *When preparing financial statements, management shall make an assessment of an entity's ability to continue as a going concern.*

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

19. In assessing whether the going concern assumption is appropriate, management takes into account all available information about the future, which is at least, but is not limited to, twelve months from the balance sheet date. The degree of consideration depends on the facts in each case. When an entity has a history of profitable operations and ready access to financial resources, a conclusion that the going concern basis of accounting is appropriate may be reached without detailed analysis. In other cases, management may need to consider a wide range of factors surrounding current and expected profitability, debt repayment schedules and potential sources of replacement financing before it can satisfy itself that the going concern basis is appropriate.

Accrual Basis of Accounting

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

Consistency of Presentation

22. *The presentation and classification of items in the financial statements shall be retained from one period to the next unless:*

- (a) a significant change in the nature of the operations of the entity or a review of its financial statement presentation demonstrates that a change in presentation results in a more appropriate presentation of transactions or other events; or*
- (b) a change in presentation is required by an International Financial Reporting Standard or an Interpretation of a Standard.*

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

Materiality and Aggregation

24. *Each material class of similar items shall be presented separately in the financial statements. Immaterial amounts can be aggregated with amounts of classes of different items, and need not be presented separately.*
25. Financial statements result from processing large numbers of recognised transactions or other events that are aggregated into classes according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data, which form line items on the face of the financial statements or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of the financial statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of the financial statements may nevertheless be sufficiently material for it to be presented separately in the notes.
26. In this context, information is material if its non-disclosure could influence the economic decisions of users taken on the basis of the financial statements. Materiality depends on the size and nature of the item or aggregation of items judged in the particular circumstances of its omission. In deciding whether an item or an aggregation of items is material, the nature and the size of the item or items are evaluated together. Depending on the circumstances, the nature or the size of the

item or items could be the determining factor. For example, individual assets with the same nature and function are aggregated into the same class even if the individual amounts are large. However, large items that differ in nature or function are presented separately.

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

Offsetting

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

- (b) expenditure that is reimbursed under a contractual arrangement with a third party (for example, a subletting agreement) is netted against the related reimbursement.
32. In addition, gains and losses arising from a group of similar transactions are reported on a net basis, for example, foreign exchange gains and losses or gains and losses arising on financial instruments held for trading purposes. Such gains and losses are, however, reported separately if their size, nature or incidence is such that separate disclosure is required by paragraph 80.

Comparative Information

33. *Unless an International Financial Reporting Standard permits or requires otherwise, comparative information shall be disclosed in respect of the previous period for all amounts reported in the financial statements. Comparative information shall be included for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.*
34. In some cases narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last balance sheet date and is yet to be resolved, are disclosed in the current period. Users benefit from information that the uncertainty existed at the last balance sheet date, and about the steps that have been taken during the period to resolve the uncertainty.
35. *When the presentation or classification of items in the financial statements is amended, comparative amounts shall be reclassified unless the reclassification would require undue cost or effort. When comparative amounts are reclassified, an entity shall disclose:*
- (a) *the nature of the reclassification;*
 - (b) *the amount of each item or class of items that is reclassified; and*
 - (c) *the reason for the reclassification.*
36. *When reclassifying comparative amounts would require undue cost or effort, an entity shall disclose:*

- (a) the reason for not reclassifying the amounts; and*
- (b) the nature of the adjustments that would have been made if the amounts were reclassified.*

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

Structure and Content

Introduction

40. This Standard requires particular disclosures on the face of the financial statements and requires other line items to be disclosed either on the face of the financial statements or in the notes. IAS 7 sets out requirements for the presentation of a cash flow statement.
41. This Standard sometimes uses the term 'disclosure' in a broad sense, encompassing items presented on the face of each financial statement as well as in the notes to the financial statements. Disclosures also are required by other International Financial Reporting Standards and Interpretations of those Standards. Unless specified to the contrary in this Standard, another Standard or an Interpretation of a Standard, such

disclosures are made on the face of the relevant financial statement or in the notes.

Identification of Financial Statements

- 42. *Financial statements shall be identified clearly and distinguished from other information in the same published document.***
43. International Financial Reporting Standards and Interpretations of those Standards apply only to the financial statements, and not to other information presented in an annual report or other document. Therefore, it is important that users can distinguish information that is prepared using International Financial Reporting Standards and Interpretations of those Standards from other information that may be useful to users but is not the subject of those requirements.
- 44. *Each component of the financial statements shall be identified clearly. In addition, the following information shall be displayed prominently, and repeated when it is necessary for a proper understanding of the information presented:***
- (a) the name of the reporting entity or other means of identification, and any change in that information from the preceding balance sheet date;***
 - (b) whether the financial statements cover the individual entity or a group of entities;***
 - (c) the balance sheet date or the period covered by the financial statements, whichever is appropriate to the related component of the financial statements;***
 - (d) the presentation currency; and***
 - (e) the level of precision used in the presentation of amounts in the financial statements.***
45. The requirements in paragraph 44 normally are met by presenting page headings and abbreviated column headings on each page of the financial statements. Judgement is required in determining the best way of presenting such information. For example, when the financial statements are presented electronically, separate pages may not be used; the above items are then presented frequently enough to ensure a proper understanding of the information given.

46. Financial statements often are made more understandable by presenting information in thousands or millions of units of the presentation currency. This is acceptable as long as the level of precision in presentation is disclosed and relevant information is not omitted.

Reporting Period

47. *Financial statements shall be presented at least annually. When an entity's balance sheet date changes and annual financial statements are presented for a period longer or shorter than one year, an entity shall disclose, in addition to the period covered by the financial statements:*
- (a) the reason for using a period other than one year; and*
 - (b) the fact that comparative amounts for the income statement, changes in equity, cash flows and related notes are not comparable.*
48. Normally, financial statements are consistently prepared covering a one-year period. However, for practical reasons, some entities prefer to report, for example, for a 52-week period. This Standard does not preclude this practice, because the resulting financial statements are unlikely to be materially different from those that would be presented for one year.

Balance Sheet

Current/Non-Current Distinction

49. *An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its balance sheet in accordance with paragraphs 54-64 except when a liquidity presentation provides more relevant and reliable information. In such cases, all assets and liabilities shall be presented broadly in order of liquidity.*
50. *Whichever method of presentation is adopted, for each asset and liability line item that combines amounts expected to be recovered or settled within no more than twelve months after the balance sheet date and more than twelve months after the balance sheet date, an*

entity shall disclose the amount expected to be recovered or settled after more than twelve months.

51. When an entity supplies goods or services within a clearly identifiable operating cycle, separate classification of current and non-current assets and liabilities on the face of the balance sheet provides useful information by distinguishing the net assets that are continuously circulating as working capital from those used in the entity's long-term operations. It also highlights assets that are expected to be realised within the current operating cycle, and liabilities that are due for settlement within the same period.
52. For some entities, such as financial institutions, a liquidity presentation of assets and liabilities provides more relevant and reliable information than a current/non-current presentation because the entity does not supply goods or services within a clearly identifiable operating cycle.
53. Information about expected dates of realisation of assets and liabilities is useful in assessing the liquidity and solvency of an entity. IAS 32, Financial Instruments: Disclosure and Presentation, requires disclosure of the maturity dates of financial assets and financial liabilities. Financial assets include trade and other receivables, and financial liabilities include trade and other payables. Information on the expected date of recovery and settlement of non-monetary assets and liabilities such as inventories and provisions also is useful, whether or not assets and liabilities are classified as current or non-current. For example, an entity discloses the amount of inventories that are expected to be recovered after more than twelve months from the balance sheet date.

Current Assets

54. *An asset shall be classified as current when it:*
 - (a) *is expected to be realised in, or is held for sale or consumption in, the normal course of the entity's operating cycle;*
 - (b) *is held primarily for trading purposes;*
 - (c) *is expected to be realised within twelve months of the balance sheet date; or*

- (d) is cash or a cash equivalent asset that is not restricted from being exchanged or used to settle a liability for at least twelve months from the balance sheet date.*

All other assets shall be classified as non-current.

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

Current Liabilities

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

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

All other liabilities shall be classified as non-current.

58. Current liabilities can be categorised similarly to current assets. Some current liabilities, such as trade payables and accruals for employee and other operating costs, are part of the working capital used in the normal operating cycle of the business. Such operating items are classified as current liabilities even if they are due to be settled after more than twelve months from the balance sheet date.
59. Other current liabilities are not settled as part of the current operating cycle, but are due for settlement within twelve months of the balance sheet date. Examples are the current portion of non-current financial liabilities, bank overdrafts, dividends payable, income taxes and other

non-trade payables. Financial liabilities that provide the financing for working capital on a long-term basis, and are not due for settlement within twelve months, are non-current liabilities.

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

64. In the circumstances described in paragraph 63, if the entity fails to rectify the breach within the period of grace, the failure confirms that, in substance, the loan was payable on demand at the balance sheet date and the liability is classified as current.

Information to be Presented on the Face of the Balance Sheet

65. *As a minimum, the face of the balance sheet shall include line items that present the following amounts:*
- (a) property, plant and equipment;*
 - (b) investment property;*
 - (c) intangible assets;*
 - (d) financial assets (excluding amounts shown under (e), (h) and (i));*
 - (e) investments accounted for using the equity method;*
 - (f) biological assets;*
 - (g) inventories;*
 - (h) trade and other receivables;*
 - (i) cash and cash equivalents;*
 - (j) trade and other payables;*
 - (k) provisions;*
 - (l) financial liabilities (excluding amounts shown under (j) and (k));*
 - (m) tax liabilities and assets;*
 - (n) minority interest; and*
 - (o) issued capital and reserves attributable to owners of the parent.*
66. *Additional line items, headings and subtotals shall be presented on the face of the balance sheet when such presentation is relevant to an understanding of the entity's financial position.*
67. This Standard does not prescribe the order or format in which items are to be presented. Paragraph 65 simply provides a list of items that

are sufficiently different in nature or function that they warrant separate presentation on the face of the balance sheet. In addition:

- (a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and
 - (b) the descriptions used and the ordering of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position. For example, a bank amends the above descriptions to apply the more specific requirements in IAS 30, Disclosures in the Financial Statements of Banks and Similar Financial Institutions.
68. The judgement on whether additional items are presented separately is based on an assessment of:
- (a) the nature and liquidity of assets;
 - (b) the function of assets within the entity; and
 - (c) the amounts, nature and timing of liabilities.
69. The use of different measurement bases for different classes of assets suggests that their nature or function differs and, therefore, that they should be presented as separate line items. For example, different classes of property, plant and equipment can be carried at cost or revalued amounts in accordance with IAS 16, Property, Plant and Equipment.

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

70. *An entity shall disclose, either on the face of the balance sheet or in the notes, further subclassifications of the line items presented, classified in a manner appropriate to the entity's operations.*
71. The detail provided in subclassifications depends on the requirements of Standards and Interpretations of those Standards and on the size, nature and function of the amounts involved. The factors set out in paragraph 68 also are used to decide the basis of subclassification. The disclosures vary for each item, for example:

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

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

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

An entity without share capital, such as a partnership, shall disclose information equivalent to that required above, showing movements

during the period in each category of equity interest, and the rights, preferences and restrictions attaching to each category of equity interest.

Income Statement

Profit or Loss for the Period

73. *All items of income and expense recognised in a period shall be included in the determination of profit or loss unless a Standard requires or permits otherwise.*
74. Normally, all items of income and expense recognised in a period are included in the determination of profit or loss. This includes the effects of changes in accounting estimates. However, circumstances may exist when particular items may be excluded from profit or loss for the current period. IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, deals with two such circumstances: the correction of errors and the effect of changes in accounting policies.
75. Other Standards deal with items that may meet the Framework definitions of income or expense but are usually excluded from the determination of profit or loss. Examples include revaluation surpluses (see IAS 16, Property, Plant and Equipment), gains and losses arising on the translation of the financial statements of a foreign operation (see IAS 21, The Effects of Changes in Foreign Exchange Rates) and gains or losses on remeasuring available-for-sale financial assets (see IAS 39, Financial Instruments: Recognition and Measurement).

Information to be Presented on the Face of the Income Statement

76. *As a minimum, the face of the income statement shall include line items that present the following amounts for the period:*
- (a) revenue;*
 - (b) finance costs;*
 - (c) share of the after-tax profit or loss of associates and joint ventures accounted for using the equity method;*

- (d) pre-tax gain or loss recognised on the disposal of assets or settlement of liabilities attributable to discontinuing operations;*
- (e) tax expense;*
- (f) profit or loss;*
- (g) minority interest; and*
- (h) net profit or loss.*

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

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

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

80. ***The nature and amount of items of income and expense that are of such size, nature or incidence that their disclosure is relevant to an understanding of the entity's financial performance shall be disclosed separately.***
81. The nature and amount of the items of income and expense described in paragraph 80 may be relevant to users of financial statements in

understanding the financial position and financial performance of an entity and in making projections about financial position and financial performance.

82. Circumstances that may give rise to the separate disclosure of items of income and expense include:
- (a) the write-down of inventories to net realisable value or property, plant and equipment to recoverable amount, as well as the reversal of such write-downs;
 - (b) a restructuring of the activities of an entity and the reversal of any provisions for the costs of restructuring;
 - (c) disposals of items of property, plant and equipment;
 - (d) disposals of long-term investments;
 - (e) discontinuing operations;
 - (f) litigation settlements; and
 - (g) other reversals of provisions.
83. ***An entity shall present an analysis of expenses using a classification based on either the nature of expenses or their function within the entity.***
84. Entities are encouraged to present the analysis in paragraph 83 on the face of the income statement.
85. Expense items are subclassified to highlight components of financial performance that may differ in terms of frequency, potential for gain or loss and predictability. This analysis is provided in one of two forms.
86. The first form of analysis is referred to as the nature of expense method. Expenses are aggregated in the income statement according to their nature (for example, depreciation, purchases of materials, transport costs, wages and salaries, and advertising costs), and are not reallocated among various functions within the entity. This method is simple to apply in many smaller entities because no allocations of expenses between functional classifications are necessary.
87. The second form of analysis is referred to as the function of expense or 'cost of sales' method and classifies expenses according to their

function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method. This method often provides more relevant information to users than the classification of expenses by nature, but the allocation of costs to functions can be arbitrary and involves considerable judgement.

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

Statement of Changes in Equity

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

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

Cash Flow Statement

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

Notes to the Financial Statements

Structure

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

100. Notes are normally presented in the following order, which assists users in understanding the financial statements and comparing them with those of other entities:
- (a) a statement of compliance with International Financial Reporting Standards and Interpretations of those Standards (see paragraph 11);
 - (b) a summary of significant accounting policies applied, including the measurement basis or bases applied;
 - (c) supporting information for items presented on the face of each financial statement in the order in which each financial statement and each line item is presented; and
 - (d) other disclosures, including:
 - (i) contingencies, commitments and other financial disclosures; and
 - (ii) non-financial disclosures.
101. In some circumstances, it may be necessary or desirable to vary the ordering of specific items within the notes. For example, information on changes in fair value recognised in profit or loss may be combined with information on maturities of financial instruments, although the former disclosures relate to the income statement and the latter relate to the balance sheet. Nevertheless, a systematic structure for the notes is retained as far as practicable.
102. Notes providing information about the basis of preparation of the financial statements and specific accounting policies may be presented as a separate component of the financial statements.

Disclosure of Accounting Policies

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

104. In addition to other accounting policies used in the financial statements, it is important for users to be aware of the measurement basis or bases used (historical cost, current cost, net realisable value, fair value or recoverable amount) because they form the basis on which the financial statements are prepared. When more than one measurement basis is used in the financial statements, for example when particular classes of assets are revalued, it is sufficient to provide an indication of the categories of assets and liabilities to which each measurement basis is applied.
105. In deciding whether a particular accounting policy should be disclosed, management considers whether disclosure would assist users in understanding how transactions and other events are reflected in the reported financial performance and financial position. An entity considers presenting accounting policies related to at least the following:
- (a) revenue recognition;
 - (b) consolidation principles;
 - (c) application of the equity method of accounting for investments in associates;
 - (d) business combinations;
 - (e) joint ventures;
 - (f) recognition and depreciation/amortisation of tangible and intangible assets;
 - (g) capitalisation of borrowing costs and other expenditure;
 - (h) construction contracts;
 - (i) investment properties;
 - (j) financial instruments and investments;
 - (k) leases;
 - (l) inventories;
 - (m) taxes, including deferred taxes;
 - (n) provisions;
 - (o) employee benefit costs;

- (p) foreign currency translation;
- (q) definition of business and geographical segments and the basis for allocation of costs between segments;
- (r) definition of cash and cash equivalents; and
- (s) government grants.

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

106. Each entity considers the nature of its operations and the policies that the users of its financial statements would expect to be disclosed for that type of entity. For example, an entity subject to income taxes would be expected to disclose its accounting policies for income taxes, including those applicable to deferred taxes and tax assets. When an entity has significant foreign operations or transactions in foreign currencies, disclosure of accounting policies for the recognition of foreign exchange gains and losses would be expected. When business combinations have occurred, the policies used for measuring goodwill and minority interest are disclosed.
107. An accounting policy may be significant even if amounts shown for current and prior periods are not material. It also is appropriate to disclose each significant accounting policy that is not specified by existing Standards and Interpretations of those Standards, but selected and applied in accordance with IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.
- 108. *An entity shall disclose, in the summary of significant accounting policies and/or other notes, the judgements made by management in applying the accounting policies that have the most significant effect on the amounts of items recognised in the financial statements.***
109. In applying accounting policies, management makes various judgements that can affect significantly the amounts of items recognised in the financial statements. For example, management makes judgements in determining whether financial assets are held-to-maturity investments. Under paragraph 108, an entity discloses those judgements made by management in applying accounting policies that have the most significant effect on the amounts of items recognised in the financial statements. These disclosures do not relate to the judgements disclosed under paragraph 110. Some of these disclosures

are required by other Standards. For example, IAS 27, Consolidated and Separate Financial Statements, requires an entity to disclose the reasons why the entity's ownership interest does not constitute control, in respect of an investee that is not a subsidiary although more than half of its voting or potential voting power is owned directly or indirectly through subsidiaries.

Key Measurement Assumptions

110. An entity shall disclose in the notes information regarding key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature; and

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

111. The key assumptions and other sources of measurement uncertainty disclosed under paragraph 110 relate to the estimates that require management's most difficult, subjective or complex judgements. As the number of variables and assumptions affecting the possible future resolution of the uncertainties increases, those judgements become more subjective and complex, and the potential for a material adjustment to the carrying amounts of assets and liabilities normally increases accordingly.

112. The disclosures under paragraph 110 are presented in a manner that assists users of financial statements to understand the judgements management makes about the future. The nature and extent of the information provided vary according to the nature of the assumption and other circumstances. Examples of the types of disclosures made are:

(a) the nature of the assumption or other measurement uncertainty;

(b) the sensitivity of carrying amounts to the methods, assumptions and estimates underlying their calculation, including the reasons for the sensitivity;

(c) the expected resolution of an uncertainty and the range of reasonably possible outcomes within the next financial year in

respect of the carrying amounts of the assets and liabilities affected; and

- (d) an explanation of changes made to past assumptions concerning those assets and liabilities, if the uncertainty remains unresolved.
113. Examples of key assumptions disclosed under paragraph 110 are future interest rates, future changes in salaries, future changes in prices affecting other costs, and useful lives.
114. When it is not possible, without undue cost or effort, to disclose the extent of the possible effects of the assumption or other measurement uncertainty, the entity discloses that it is reasonably possible, based on existing knowledge, that changes in conditions within the next financial year could require a material adjustment to the carrying amount of the asset or liability affected. In all cases, the entity discloses the nature and carrying amount of the asset or liability affected.
115. Some key assumptions referred to in paragraph 110 are disclosed under other Standards. For example, IAS 37, Provisions, Contingent Liabilities and Contingent Assets, requires disclosure, in certain circumstances, of major assumptions concerning future events affecting classes of provisions. In addition, IAS 32, Financial Instruments: Disclosure and Presentation requires disclosure of significant assumptions applied in estimating fair values of financial assets and financial liabilities that are carried at fair value.

Other Disclosures

116. An entity shall disclose in the notes:

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

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

- (a) *the domicile and legal form of the entity;*

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

Effective Date

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

Appendix A

Basis for Conclusions (Revisions 200X)

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

Departures from Standards and Interpretations

- A3. Paragraph 13 of IAS 1 permits an entity to depart from a requirement in a Standard 'in the extremely rare circumstances when management concludes that compliance with a requirement in a Standard would be misleading, and therefore that departure from a requirement is necessary to achieve a fair presentation'. When such a departure occurs, paragraph 13 requires extensive disclosure of the facts and circumstances surrounding the departure and the treatment adopted.
- A4. The Board proposes to clarify in paragraph 10 that financial statements present fairly the financial position, financial performance and cash flows of an entity when they represent faithfully the effects of transactions and other events in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses set out in the Framework for the Preparation and Presentation of Financial Statements.
- A5. The Board proposes to limit the circumstances in which an entity departs from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard to the extremely rare circumstances in which management concludes that compliance with

the requirement would be so misleading that it would conflict with the objective of financial statements set out in the Framework. Proposed guidance on this criterion states that an item of information would conflict with the objective of financial statements when it does not represent faithfully the transactions or other events that it either purports to represent or could reasonably be expected to represent and, consequently, it would be likely to affect adversely economic decisions made by users of financial statements.

- A6. The effect of these proposed amendments is to provide a framework within which an entity assesses how to present fairly the effects of transactions and other events, and within which an entity assesses whether complying with a requirement in an International Financial Reporting Standard or an Interpretation of a Standard is so misleading that it would not result in fair presentation.
- A7. When it developed these proposals, the Board discussed whether IAS 1 should be silent regarding departures from International Financial Reporting Standards or Interpretations of those Standards. The Board decided against that change, noting that such a change would remove its capability to specify the criteria under which departures from those Standards and Interpretations should occur.
- A8. When considering this issue, the Board also noted that requiring an entity to depart from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard where considered necessary to achieve fair presentation would conflict with the regulatory framework in some jurisdictions. The Board proposes to amend IAS 1 to take into account the different regulatory frameworks concerning departures from accounting standards in the various jurisdictions in which entities prepare financial statements. Accordingly, the Exposure Draft proposes that when an entity's circumstances satisfy the criterion described in paragraph A5 for departure from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard:
- (a) if the relevant regulatory framework requires ~~or~~ otherwise does not prohibit a departure from the requirement, the entity shall make that departure and the disclosures set out in proposed paragraph 14; and
 - (b) if the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible,

reduce the perceived misleading aspects of compliance by making the disclosures set out in proposed paragraph 15.

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

- A9. In some jurisdictions, the relevant regulatory framework is silent on whether an entity may depart from a requirement in an accounting standard in particular circumstances. The Board concluded that under the principle that entities should, to the maximum extent possible, ensure that financial statements provide a fair presentation, an entity should be required to depart from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard whenever:
- (a) its circumstances satisfy the criterion for departure described in paragraph A5; and
 - (b) the relevant regulatory framework does not prohibit such a departure.
- A10. In view of the strict criteria proposed for departure from a requirement in an International Financial Reporting Standard or an Interpretation of a Standard, the Board proposes to include guidance that there is a rebuttable presumption that if other entities in similar circumstances comply with the requirement, the entity's compliance with the requirement would not be so misleading that it would conflict with the objective of financial statements set out in the Framework.

Extraordinary items

- A11. IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies, requires extraordinary items to be disclosed on the face of the income statement separately from the profit or loss from ordinary activities (paragraph 10). Paragraph 6 of IAS 8 defines 'extraordinary items' as 'income or expenses that arise from events or transactions that are clearly distinct from the ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly'.

- A12. The Board is proposing to eliminate the concept of extraordinary items from IAS 8 and to prohibit the presentation of items of income and expense as ‘extraordinary items’ in the income statement and the notes. This prohibition would be set out in the revised IAS 1.
- A13. Some commentators on accounting standards have argued that extraordinary items should be presented in a separate component of the income statement because they are clearly distinct from all of the other items of income and expense, and because such presentation highlights to users of financial statements the items of income and expense to which the least attention should be given when predicting an entity’s future performance.
- A14. The Board noted that items treated as extraordinary result from the normal business risks faced by an entity and decided they do not warrant presentation in a separate component of the income statement. The nature of a transaction or other event, rather than its frequency, should determine its presentation within the income statement. Items currently classified as ‘extraordinary’ are only a subset of the items of income and expense that may warrant disclosure to assist users in predicting an entity’s future performance.
- A15. Eliminating the category of extraordinary items should eliminate the need for arbitrary segregation of the effects of related external events – some recurring and others not – on the profit or loss of an entity for a period. For example, arbitrary allocations may be necessary to estimate the financial effect of an earthquake on an entity’s profit or loss if it occurs during a major cyclical downturn in economic activity.
- A16. The Board has in progress a project on Reporting Financial Performance, which addresses a number of issues concerning the presentation of information in the income statement. However, the Board decided to address extraordinary items as a part of its Improvements project. It is a discrete issue that provides an opportunity to enhance international convergence of accounting standards.

Minority interest

- A17. As a consequence of eliminating the category of extraordinary items, the line item ‘minority interest’ (that is, the portion of profit or loss attributable to minority interest) is the only difference between the line items ‘profit or loss’ and ‘net profit or loss’ required to be presented on

the face of the income statement under proposed paragraph 76. Some Board members believe this presentation implies 'minority interest' is an item of income or expense, and that IAS 1 should not require this presentation. Other Board members believe 'minority interest' can be regarded as an attribution or apportionment of profit or loss that is not an item of income or expense.

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

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

A19. Paragraph 63 of IAS 1 includes:

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

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

A20. Paragraph 65 of IAS 1 states that:

“Some borrowing agreements incorporate undertakings by the borrower (covenants) which have the effect that the liability becomes payable on demand if certain conditions related to the

borrower's financial position are breached. In these circumstances, the liability is classified as non-current only when:

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

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

A22. The Board decided to propose the following amendments:

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

- (i) the entity rectifies the breach within the period of grace; or
- (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified (see proposed paragraphs 62-64).

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

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

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

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

Disclosure of judgements made by management in applying accounting policies

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

Disclosure of key measurement assumptions

A27. The Board proposes to require disclosure of key assumptions about the future, and other sources of measurement uncertainty, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the proposed disclosures include details of:

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

A28. Determining the carrying amounts of various types of assets and liabilities requires the use of estimates of the effects of uncertain future events. For example, future-oriented estimates are necessary to measure the recoverable amount of classes of property, plant and equipment, the rate of technological obsolescence of inventories and specialised equipment, provisions subject to the effects of future litigation or legislation, and long-term employee benefit liabilities such as pension obligations. These estimates involve assumptions about such items as future interest rates, future changes in salaries and future changes in prices affecting other costs. No matter how diligently an entity estimates the carrying amounts of assets and

liabilities subject to significant measurement uncertainty, the reporting of a point estimate in the balance sheet cannot capture all of the relevant information about the measurement of those assets and liabilities and the implications of those measures for the period's profit or loss.

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

Appendix B

Alternative Views

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

Net profit or loss

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

statement in determining an item called 'profit or loss' or 'net profit or loss'.

**Proposed Improvements to
International Accounting Standard IAS 2**
(revised 1993)

Inventories

International Accounting Standard IAS 2

(revised 200X)

Inventories

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

Invitation to Comment

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

Question 1

Do you agree with eliminating the allowed alternative of using the last-in, first-out (LIFO) method for determining the cost of inventories under paragraphs 23 and 24 of IAS 2?

Question 2

IAS 2 requires reversal of write-downs of inventories when the circumstances that previously caused inventories to be written down below cost no longer exist (paragraph 30). IAS 2 also requires the amount of any reversal of any write-down of inventories to be recognised in profit or loss (paragraph 31).

Do you agree with retaining those requirements?

Summary of Main Changes

The main changes proposed are:

- to delete ‘producers’ in paragraph 1(c). This change extends the scope exception to non-producers such as those brokers and dealers whose inventories are measured at net realisable value in accordance with well-established practices.
- to delete paragraph 9 as a result of the proposed elimination of the allowed alternative treatment in paragraph 21 of IAS 21, The Effects of Changes in Foreign Exchange Rates.
- to eliminate the allowed alternative of using the last-in, first-out (LIFO) method (paragraphs 23 and 24).
- to change paragraph 34(c) to require disclosure of the amount of any write-down of inventories.
- to delete paragraphs 37-39, which are unnecessary because the required disclosures are also required by IAS 1, Presentation of Financial Statements.
- SIC-1, Consistency – Different Cost Formulas for Inventories is withdrawn as it is covered in SIC-18, Consistency – Alternative Methods, which is incorporated into IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

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APPENDIX:

Basis for Conclusions (Revisions 200X)

International Accounting Standard IAS 2 (revised 1993 200X)

Inventories

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

Objective

The objective of this Standard is to prescribe the accounting treatment for inventories ~~under the historical cost system~~. A primary issue in accounting for inventories is the amount of cost to be recognised as an asset and carried forward until the related revenues are recognised. This Standard provides ~~practical~~ guidance on the determination of cost and its subsequent recognition as an expense, including any write-down to net realisable value. It also provides guidance on the cost formulas that are used to assign costs to inventories.

Scope

1. *This Standard shall ~~should~~ be applied in ~~financial statements prepared in the context of the historical cost system in accounting for inventories other than~~. It does not apply to:*

 - (a) *work in progress arising under construction contracts, including directly related service contracts (see IAS 11, Construction Contracts);*
 - (b) *financial instruments;*
 - (c) *~~producers' inventories of agricultural and forest products, and mineral ores and agricultural produce~~ to the extent that they are measured at net realisable value in accordance with well established practices in certain industries; and*

(d) biological assets related to agricultural activity (see IAS 41, Agriculture).

2. ~~[Deleted] This Standard supersedes IAS 2, Valuation and Presentation of Inventories in the Context of the Historical Cost System, approved in 1975.~~
3. The inventories referred to in paragraph 1(c) are measured at net realisable value at certain stages of production. This occurs, for example, when agricultural crops have been harvested or mineral ores have been extracted and sale is assured under a forward contract or a government guarantee, or when an active ~~a homogenous~~ market exists and there is a negligible risk of failure to sell. These inventories are excluded from the scope of this Standard.

Definitions

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

Inventories *are assets:*

- (a) held for sale in the ordinary course of business;*
- (b) in the process of production for such sale; or*
- (c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.*

Net realisable value *is the estimated selling price in the ordinary course of business less the estimated costs of completion and the estimated costs necessary to make the sale.*

5. Inventories encompass goods purchased and held for resale including, for example, merchandise purchased by a retailer and held for resale, or land and other property held for resale. Inventories also encompass finished goods produced, or work in progress being produced, by the ~~entity enterprise~~ and include materials and supplies awaiting use in the production process. In the case of a service provider, inventories include the costs of the service, as described in paragraph 16, for which the ~~entity enterprise~~ has not yet recognised the related revenue (see IAS 18, Revenue).

Measurement of Inventories

6. *Inventories ~~shall~~ ~~should~~ be measured at the lower of cost and net realisable value.*

Cost of Inventories

7. *The cost of inventories ~~shall~~ ~~should~~ 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

8. The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity ~~enterprise~~ from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.
9. ~~[Deleted] The costs of purchase may include foreign exchange differences which arise directly on the recent acquisition of inventories invoiced in a foreign currency in the rare circumstances permitted in the allowed alternative treatment in IAS 21, The Effects of Changes in Foreign Exchange Rates. These exchange differences are limited to those resulting from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise on the recent acquisition of the inventories.~~

Costs of Conversion

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

that vary directly, or nearly directly, with the volume of production, such as indirect materials and indirect labour.

11. 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 recognised as an expense in the period in which they are incurred. In periods of abnormally high production, the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.
12. 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 realisable 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

13. 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.
14. Examples of costs excluded from the cost of inventories and recognised as expenses in the period in which they are incurred are:

- (a) abnormal amounts of wasted materials, labour, or other production costs;
 - (b) storage costs, unless those costs are necessary in the production process prior to a further production stage;
 - (c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and
 - (d) selling costs.
15. In limited circumstances, borrowing costs are included in the cost of inventories. These circumstances are identified in the allowed alternative treatment in IAS 23, Borrowing Costs.

Cost of Inventories of a Service Provider

16. When revenues related to services provided have not been recognised, a service provider has inventories. The cost of inventories of a service provider consists primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-production costs that are often factored into prices charged by service providers.

Cost of Agricultural Produce Harvested from Biological Assets

- 16A. Under IAS 41, Agriculture, inventories comprising agricultural produce that an entity ~~enterprise~~ has harvested from its biological assets are measured on initial recognition at their fair value less estimated point-of-sale costs at the point of harvest. This is the cost of the inventories at that date for application of this Standard.

Techniques for the Measurement of Cost

17. 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, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions.

18. The retail method is often used in the retail industry for measuring inventories of large numbers of rapidly changing items, ~~that with~~ have similar margins, and for which it is impracticable to use other costing methods. The cost of the inventory is determined by reducing the sales value of the inventory by the appropriate percentage gross margin. The percentage used takes into consideration inventory ~~which~~ that has been marked down to below its original selling price. An average percentage for each retail department is often used.

Cost Formulas

19. *The cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects shall ~~should~~ be assigned by using specific identification of their individual costs.*
20. Specific identification of cost means that specific costs are attributed to identified items of inventory. This is the ~~an~~ appropriate treatment for items that are segregated for a specific project, regardless of whether they have been bought or produced. However, specific identification of costs is inappropriate when there are large numbers of items of inventory ~~which~~ 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 net profit or loss ~~for the period~~.

Benchmark Treatment

21. *The cost of inventories, other than those dealt with in paragraph 19, shall ~~should~~ 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.*

21A. For example, inventories used in one business segment may have a use to the entity different from the same type of inventories used in

[†]See also SIC 1, Consistency—Different Cost Formulas for Inventories.

another business segment. However, a difference in geographical location of inventories (or in the respective tax rules), by itself, is not sufficient to justify the use of different cost formulas.

22. The FIFO formula assumes that the items of inventory ~~which~~ that were purchased or produced 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 ~~enterprise~~.

Allowed Alternative Treatment

23. ~~[Deleted] The cost of inventories, other than those dealt with in paragraph 19, should be assigned by using the last-in, first-out (LIFO) formula.[†]~~
24. ~~[Deleted] The LIFO formula assumes that the items of inventory which were purchased or produced last are sold first, and consequently the items remaining in inventory at the end of the period are those first purchased or produced.~~

Net Realisable Value

25. 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 have increased. The practice of writing inventories down below cost to net realisable value is consistent with the view that assets should not be carried in excess of amounts expected to be realised from their sale or use.
26. Inventories are usually written down to net realisable 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

[†] See also SIC—1, Consistency—Different Cost Formulas for Inventories.

inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area, and cannot be practicably evaluated separately from other items in that product line. It is not appropriate to write inventories down based on a classification of inventory, for example, finished goods, or all the inventories in a particular industry or geographical segment. Service providers generally accumulate costs in respect of each service for which a separate selling price ~~is will be~~ charged. Therefore, each such service is treated as a separate item.

27. Estimates of net realisable value are based on the most reliable evidence available at the time the estimates are made as to the amount the inventories are expected to realise. These estimates take into consideration fluctuations of price or cost directly relating to events occurring after the end of the period to the extent that such events confirm conditions existing at the end of the period.
28. Estimates of net realisable value also take into consideration the purpose for which the inventory is held. For example, the net realisable 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 realisable value of the excess is based on general selling prices. Provisions or contingent liabilities may arise from firm sales contracts in excess of inventory quantities held or from firm purchase contracts. Such provisions or contingent liabilities are dealt with under IAS 37, Provisions, Contingent Liabilities and Contingent Assets.
29. 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 at or above cost. However, when a decline in the price of materials indicates that the cost of the finished products ~~will exceeds~~ net realisable value, the materials are written down to net realisable value. In such circumstances, the replacement cost of the materials may be the best available measure of their net realisable value.
30. A new assessment is made of net realisable value in each subsequent period. When the circumstances ~~which~~ that previously caused inventories to be written down below cost no longer exist, the amount of the write-down is reversed so that the new carrying amount is the lower of the cost and the revised net realisable value. This occurs, for example, when an item of inventory, which is carried at net realisable

value because its selling price has declined, is still on hand in a subsequent period and its selling price has increased.

Recognition as an Expense

31. *When inventories are sold, the carrying amount of those inventories shall ~~should~~ be recognised as an expense in the period in which the related revenue is recognised. The amount of any write-down of inventories to net realisable value and all losses of inventories shall ~~should~~ be recognised as an expense in the period the write-down or loss occurs. The amount of any reversal of any write-down of inventories, arising from an increase in net realisable value, shall ~~should~~ be recognised as a reduction in the amount of inventories recognised as an expense in the period in which the reversal occurs.*
32. ~~[Deleted] The process of recognising as an expense the carrying amount of inventories sold results in the matching of costs and revenues.~~
33. 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 recognised as an expense during the useful life of that asset.

Disclosure

34. *The financial statements shall ~~should~~ 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 ~~enterprise~~;*
 - (c) the amount of any write-down of inventories recognised in accordance with paragraph 31 ~~the carrying amount of inventories carried at net realisable value~~;*
 - (d) the amount of any reversal of any write-down that is recognised as income in the period in accordance with paragraph 31;*
 - (e) the circumstances or events that led to the reversal of a write-down of inventories in accordance with paragraph 31; and*

(f) the carrying amount of inventories pledged as security for liabilities.

35. 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 simply be described as work in progress.
36. ~~[Deleted] *When the cost of inventories is determined using the LIFO formula in accordance with the allowed alternative treatment in paragraph 23, the financial statements should disclose the difference between the amount of inventories as shown in the balance sheet and either:*~~
- ~~(a) *the lower of the amount arrived at in accordance with paragraph 21 and net realisable value; or*~~
- ~~(b) *the lower of current cost at the balance sheet date and net realisable value.*~~
37. ~~[Deleted] *The financial statements should disclose either:*~~
- ~~(a) *the cost of inventories recognised as an expense during the period; or*~~
- ~~(b) *the operating costs, applicable to revenues, recognised as an expense during the period, classified by their nature.*~~
38. ~~[Deleted] The cost of inventories recognised as an expense during the period consists of those costs previously included in the measurement of the items of inventory sold and unallocated production overheads and abnormal amounts of production costs of inventories. The circumstances of the enterprise may also warrant the inclusion of other costs, such as distribution costs.~~
39. ~~[Deleted] Some enterprises adopt a different format for the income statement which results in different amounts being disclosed instead of the cost of inventories recognised as an expense during the period. Under this different format, an enterprise discloses the amounts of operating costs, applicable to revenues for the period, classified by their nature. In this case, the enterprise discloses the costs recognised~~

as an expense for raw materials and consumables, labour costs and other operating costs together with the amount of the net change in inventories for the period.

40. ~~[Deleted] A write down to net realisable value may be of such size, incidence or nature to require disclosure under IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.~~

Effective Date

41. *This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact. This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1995.*

Appendix

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of standards, including IAS 2. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to the accounting for inventories established by IAS 2, this Basis for Conclusions does not discuss requirements in IAS 2 that the Board has not reconsidered.

Cost formulas

- A3. The combination of IAS 2 (revised 1993) and SIC-1, Consistency – Different Cost Formulas for Inventories allows some choice between first-in, first-out or weighted average cost formulas (benchmark treatment) and the last-in, first-out (LIFO) method (allowed alternative treatment). When the LIFO method is used, additional disclosure is required under paragraph 36 of IAS 2. The Board decided to propose that the allowed alternative of using the LIFO method be eliminated.
- A4. The LIFO method assumes that the newest items of inventory are sold first, and consequently that the items remaining in inventory are the oldest. This is generally not a reliable representation of the actual inventory flows.
- A5. The Board noted that, because of the lack of representational faithfulness in relation to physical inventory flows, LIFO can have marked distorting effects on net profit or loss, especially when 'preserved' older 'layers' of inventory are presumed to have been used

when inventories are substantially reduced. It is more likely in these circumstances that relatively new inventories will have been used to meet the increased demands on inventory.

- A6. The Board recognises that, in some jurisdictions, use of the LIFO method for tax purposes is possible only if that method is also used for accounting purposes. The Board believes, however, that tax considerations do not provide an adequate conceptual basis for selecting an appropriate accounting treatment and that it is not acceptable to allow an accounting treatment purely because of tax regulations and advantages in particular jurisdictions.
- A7. IAS 2 would continue to allow the use of both the FIFO and the weighted average methods for interchangeable inventories.

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

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

International Accounting Standard IAS 8 **(revised 200X)**

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

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

Invitation to Comment

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

Question 1

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

Question 2

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

Summary of Main Changes

The main changes proposed are:

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

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

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

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

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

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

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

SIC-18 would be withdrawn.

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

- present comparative information as it was reported in the financial statements of prior periods.

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

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

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

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APPENDIX:

Basis for Conclusions (Revisions 200X)

International Accounting Standard IAS 8 (revised 200X)

Accounting Policies, Changes in Accounting Estimates and Errors

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

Objective

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

Scope

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

Definitions

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

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

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

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

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

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

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

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

- (a) applying the new accounting policy to transactions, other events and circumstances occurring after the date as at which the policy is changed; and***
- (b) recognising and disclosing the effect of the change in the accounting estimate in the periods affected by the change.***

Accounting Policies

Selection of Accounting Policies

4. *When an International Financial Reporting Standard or an Interpretation of a Standard applies to an item in the financial statements, the accounting policy or policies applied to that item shall be determined by considering the following in descending order:*
 - (a) *the Standard (including any Appendices that form a part of the Standard);*
 - (b) *the Interpretation;*
 - (c) *Appendices to the Standard that do not form a part of the Standard; and*
 - (d) *Implementation Guidance issued in respect of the Standard.*
5. *In the absence of a particular Standard or an Interpretation of a Standard that specifically applies to an item in the financial statements, management shall use its judgement in developing and applying an accounting policy that results in information that is:*
 - (a) *relevant to the decision-making needs of users; and*
 - (b) *reliable in that the financial statements:*
 - (i) *represent faithfully the results and financial position of the entity;*
 - (ii) *reflect the economic substance of transactions and other events, and not merely the legal form;*
 - (iii) *are neutral, ie free from bias;*
 - (iv) *are prudent; and*
 - (v) *are complete in all material respects.*
6. *In making the judgement described in paragraph 5, management shall consider the following sources in descending order:*
 - (a) *the requirements and guidance in Standards, and Interpretations of Standards, dealing with similar and related*

issues, and Appendices and Implementation Guidance issued in respect of those Standards;

- (b) the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses set out in the Framework for the Preparation and Presentation of Financial Statements; and*
- (c) pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature, and accepted industry practices, to the extent, but only to the extent, that these are consistent with (a) and (b) of this paragraph.*

Consistency of Accounting Policies

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

Changes in Accounting Policies

- 9. *A change in an accounting policy shall be made only if it:*
 - (a) is required by a Standard or an Interpretation of a Standard; or*
 - (b) results in a more relevant and reliable presentation in the financial statements of the effects of transactions or other events on the entity's financial position, financial performance or cash flows.*
- 10. Users need to be able to compare the financial statements of an entity over a period of time to identify trends in its financial position, financial performance and cash flows. Therefore, the same accounting

policies are adopted in each period unless a change in an accounting policy meets one of the criteria in paragraph 9.

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

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

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

Adoption of a Standard

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

- (a) the fact that the change in an accounting policy is made in accordance with the transitional provisions of the Standard, with a description of those provisions;*
 - (b) the amount of the adjustment for the current period and for each prior period presented;*
 - (c) the amount of the adjustment relating to periods prior to those included in the comparative information; and*
 - (d) the fact that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.*
- 16. When applying the transitional provisions of a Standard may have an effect in future periods, an entity shall disclose the fact that the change in an accounting policy is made in accordance with the transitional provisions of the Standard, with a description of those provisions affecting future periods.**
17. Enhancing the inter-period comparability of information assists users in making economic decisions, especially by allowing the assessment of trends in financial information for predictive purposes. There is a general presumption, therefore, that the benefits from restating comparative information exceed the resulting cost or effort and, accordingly, that an entity would make every reasonable effort to restate comparative amounts for each prior period presented.
18. In some circumstances, the cost or effort of restating comparative information for a particular prior period to achieve comparability with the current period would exceed the resulting benefits to be derived by users of financial statements. For example, data may not have been collected in the prior period(s) in a way that allows restatement, and recreating the information would require undue cost or effort. In such circumstances, an entity discloses the reason for not restating the comparative amounts.
- 19. When an entity has not adopted a new Standard that has been issued but not yet come into effect, the entity shall disclose:**
- (a) the nature of the future change or changes in accounting policy;*
 - (b) the date by which adoption of the Standard is required;*

- (c) the date as at which it plans to adopt the Standard; and*
- (d) either:*
 - (i) an estimate of the effect of the change(s) on its financial position; or*
 - (ii) if such an estimate cannot be made without undue cost or effort, a statement to that effect.*

Voluntary Changes in Accounting Policies

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

- (c) *the amount of the adjustment relating to periods prior to those presented; and*
- (d) *that comparative information has been restated, or that restatement for a particular prior period has not been made because it would require undue cost or effort.*

Changes in Accounting Estimates

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

28. Prospective recognition of the effect of a change in an accounting estimate means that the change is applied to transactions, other events, and circumstances from the date of the change in estimate. A change in an accounting estimate may affect the current period only, or both the current period and future periods. For example, a change in the estimate of the amount of bad debts affects only the current period and therefore is recognised in the current period. However, a change in the estimated useful life of, or the expected pattern of consumption of the future economic benefits embodied in, a depreciable asset affects depreciation expense for the remainder of the current period and for each future period during the asset's remaining useful life. In both cases, the effect of the change relating to the current period is recognised as income or expense in the current period. The effect, if any, on future periods is recognised in future periods.
29. *The nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in subsequent periods shall be disclosed, subject to paragraph 30.*
30. *The amount of the effect on subsequent periods of a change in an accounting estimate need not be disclosed if estimating it would require undue cost or effort. If the amount of the effect in subsequent periods is not disclosed because estimating it requires undue cost or effort, that fact shall be disclosed.*

Errors

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

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

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

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

Disclosure of Errors

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

Effective Date

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

Appendix

Basis for Conclusions (Revisions 200X)

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

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

- A3. IAS 8 includes allowed alternative treatments of voluntary changes in accounting policies (paragraphs 54-57) and corrections of fundamental errors (paragraphs 38-40). Under those allowed alternatives:
- (a) the adjustment resulting from retrospective application of a change in an accounting policy is included in profit or loss for the current period; and
 - (b) the amount of the correction of a fundamental error is included in profit or loss for the current period.
- A4. In both circumstances, comparative information is presented as it was reported in the financial statements of prior periods.
- A5. The Board identified the removal of optional treatments for changes in accounting policies and corrections of errors as an important improvement to IAS 8. The Board is proposing to remove the allowed alternative treatments and require application of the benchmark treatments. Under the benchmark treatments for changes in

accounting policies and corrections of errors, including the amendments proposed in paragraphs 20, 21, 32 and 33, these changes and corrections are accounted for retrospectively.

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

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

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

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

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

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

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

- (a) profit or loss for the period of the change does not include effects of changes in accounting policies or errors relating to prior periods;
- (b) information presented in respect of prior periods is prepared on the same basis as the basis applied for the current period, and therefore is comparable. This information possesses a qualitative characteristic in the Framework for the Preparation and Presentation of Financial Statements, and provides the most useful information for trend analysis of income and expenses; and

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

Eliminating the distinction between fundamental errors and other material errors

- A13. The Board also proposes to eliminate the distinction between fundamental errors and other material errors. Under this amendment, all material errors would be treated in the same manner as a fundamental error currently is treated under the benchmark treatment. The Board concluded that the definition of 'fundamental errors' in

EXPOSURE DRAFT OF REVISED IAS 8

IAS 8 is difficult to interpret consistently because the key feature of the definition—that the error causes the financial statements of one or more prior periods no longer to be considered to have been reliable—is also a feature of other material errors.

**Proposed Improvements to
International Accounting Standard IAS 10**
(revised 1999)

Events After the Balance Sheet Date

International Accounting Standard IAS 10

(revised 200X)

Events After the Balance Sheet Date

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

Summary of Main Changes

The main change proposed is to revise paragraphs 11 and 12 to indicate that if dividends are declared after the balance sheet date, an entity should not recognise those dividends as a liability at the balance sheet date.

A Basis for Conclusions for this change is not included in this Exposure Draft, given that the reason for this change is indicated in paragraph 12.

Contents

Limited revisions to International Accounting Standard IAS 10 (revised ~~1999~~ 200X)

Events After the Balance Sheet Date

[Marked-up text]

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Limited revisions to International Accounting Standard IAS 10 (revised 1999 200X)

Events After the Balance Sheet Date

[Marked-up text]

Recognition and Measurement

[amend paragraphs 8(a), 11 and 12 as follows]:

Adjusting Events After the Balance Sheet Date

8. The following are examples of adjusting events after the balance sheet date that require an entity enterprise to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:
- (a) the settlement resolution after the balance sheet date of a court case that which, because it confirms that an entity enterprise ~~already~~ had a present obligation at the balance sheet date, ~~requires~~ requires ~~†The entity enterprise to adjust~~ any a provision previously already recognised related to this court case in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets, or to recognises a new provision instead of merely disclosing a contingent liability because the settlement provides additional evidence that would be considered in accordance with paragraph 16 of IAS 37;

...

Dividends

11. *If dividends to holders of equity instruments (as defined in IAS 32, Financial Instruments: Disclosure and Presentation) are ~~proposed or~~ declared after the balance sheet date, an entity enterprise ~~should~~ shall not recognise those dividends as a liability at the balance sheet date.*

12. ~~If IAS 1, Presentation of Financial Statements, requires an enterprise to disclose the amount of dividends are that were proposed or declared after the balance sheet date but before the financial statements are were authorised for issue, the dividends are not recognised as a liability in the period covered by the financial statements because they do not meet the criteria of a present obligation in IAS 37, Provisions, Contingent Liabilities and Contingent Assets. Such dividends are disclosed in the notes to the financial statements in accordance with IAS 1 (revised 200X), Presentation of Financial Statements. IAS 1 permits an enterprise to make this disclosure either:~~
- ~~(a) on the face of the balance sheet as a separate component of equity; or~~
 - ~~(b) in the notes to the financial statements.~~

Disclosure

[amend paragraphs 20 and 21 as follows]:

Non-Adjusting Events After the Balance Sheet Date

20. ~~*If Where non-adjusting events after the balance sheet date are material of such importance that, non-disclosure would influence the economic decisions of users taken on the basis of the financial statements affect the ability of the users of the financial statements to make proper evaluations and decisions. Accordingly, an entity enterprise shall should disclose the following information for each material significant category of non-adjusting event after the balance sheet 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.*~~
21. The following are examples of non-adjusting events after the balance sheet date that would generally result in disclosure that may be of such importance that non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions:

...

- (f) major ordinary share transactions and potential ordinary share transactions after the balance sheet date (IAS 33, Earnings Per Share, requires an entity encourages an enterprise to disclose a description of such transactions, other than capitalisation or bonus issues, share splits or reverse and share splits);

...

Effective Date

[amend paragraph 22, add new paragraph 22A and delete paragraph 23]

22. *This ~~International Accounting Standard~~ becomes operative for annual financial statements covering periods beginning on or after 1 January 2000, except as specified in paragraph 22A.*

22A. Paragraphs 11 and 20 become operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact.

23. [~~Deleted~~] In 1998, IAS 37, Provisions, Contingent Liabilities and Contingent Assets, superseded the parts of IAS 10, Contingencies and Events Occurring After the Balance Sheet Date, that dealt with contingencies. This Standard supersedes the rest of that Standard.

**Proposed Withdrawal of
International Accounting Standard IAS 15
(reformatted 1994)**

**Information Reflecting
the Effects of Changing Prices**

International Accounting Standard IAS 15
(reformatted 1994)

Information Reflecting
the Effects of Changing Prices

Withdrawal of IAS 15 (reformatted 1994)

Information Reflecting the Effects of Changing Prices

IAS 15, Information Reflecting the Effects of Changing Prices, was originally approved by the Board of IASC in June 1981. IAS 15 encourages particular disclosures of information reflecting the effects of changing prices.

At its meeting in October 1989, the Board of IASC approved the following statement to be added to IAS 15:

“The international consensus on the disclosure of information reflecting the effects of changing prices that was anticipated when IAS 15 was issued has not been reached. As a result, the Board of IASC has decided that enterprises need not disclose the information required by IAS 15 in order that their financial statements conform with International Accounting Standards. However, the Board encourages enterprises to present such information and urges those that do to disclose the items required by IAS 15.”

As indicated above, entities do not have to apply IAS 15. In addition, the Board understands that few entities, if any, are using IAS 15. Moreover, the Board does not believe that entities should be required to disclose information that reflects the effects of changing prices in the current economic environment. Accordingly, the Board proposes to withdraw IAS 15 as of 1 January 2003.

**Proposed Improvements to
International Accounting Standard IAS 16**
(revised 1998)

Property, Plant and Equipment

International Accounting Standard IAS 16

(revised 200X)

Property, Plant and Equipment

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

Invitation to Comment

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

Question 1

Do you agree that all exchanges of items of **property, plant and equipment** should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably (see paragraphs 21 and 21A)?

Question 2

Do you agree that all exchanges of **intangible assets** should be measured at fair value, except when the fair value of neither of the assets exchanged can be determined reliably? (See the amendments in paragraphs 34-34B of IAS 38, Intangible Assets, proposed as a consequence of the proposal described in Question 1.)

(Note that the Board has decided not to amend, at this time, the prohibition in IAS 18, Revenue, on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board will review that policy later in the context of a future project on the Recognition of Revenue.)

Question 3

Do you agree that depreciation of an item of property, plant and equipment should not cease when it becomes temporarily idle or is retired from active use and held for disposal (see paragraph 59)?

Summary of Main Changes

The main changes proposed are:

- to amend the definition of 'residual value' in paragraph 6 for greater consistency with the guidance in the last sentence of paragraph 46. The amended definition would require an entity to use current prices for assets of a similar age and condition to the estimated age and condition of the asset when it reaches the end of its useful life.
- to amend paragraph 12 to clarify that a component approach to depreciation and to the treatment of expenditure to replace or renew a component of an item of property, plant and equipment is applied to all such items. Under a component approach, each material component of an asset with a different useful life or different pattern of depreciation is depreciated separately and expenditure on replacing or renewing the component is capitalised. This amendment would achieve greater consistency with paragraph 27 of IAS 16 (see paragraph 22B).
- to insert in paragraph 15 additional guidance that the directly attributable costs included in the cost of an item of property, plant and equipment:
 - are those to bring the asset to the location and working condition necessary for it to be capable of operating in the manner intended by management (including those to test whether the asset is functioning properly); and
 - are determined after deducting the net proceeds from selling any items produced when bringing the asset to that location and condition.
- to add paragraph 17B to provide guidance on the treatment of income and related expenses of operations that are incidental to the construction or development of an item of property, plant and equipment.
- to include paragraphs 20A and 20B to provide additional guidance on the principle that the cost of an item of property, plant and equipment includes the costs of dismantling and removing the asset and restoring the site on which that asset is located (this principle was stated in paragraph 15(e) of IAS 16).

- to amend paragraphs 21 and 22 to specify that exchanges of items of property, plant and equipment (regardless of whether the assets are similar) are measured at fair value, except that when the fair value of neither of the assets exchanged can be determined reliably, the cost of the asset acquired in the exchange is measured at the carrying amount of the asset given up. For the purpose of applying this requirement, amended paragraph 21 indicates that the fair value of the asset received is used to measure its cost if it is more clearly evident than the fair value of the asset given up. This would amend the requirement in paragraph 22 to measure the cost of the asset acquired at the carrying amount of the asset given up in respect of the following exchanges:
 - an acquisition of an item of property, plant and equipment in exchange for a similar asset that has a similar use in the same line of business and a similar fair value; and
 - a sale of an item of property, plant and equipment in exchange for an equity interest in a similar asset.

As a consequence, paragraph 11 of SIC-13, Jointly Controlled Entities –Non-Monetary Contributions by Venturers, would be deleted.

- to add paragraph 22A to specify that a component approach is applied to depreciation and to the treatment of expenditure to replace or renew a component of an item of property, plant and equipment.
- to add paragraphs 22C and 22D to provide guidance that the component approach specified in paragraph 22A is applied when a separate component of an item of property, plant and equipment is identified in respect of a major inspection to enable the continued use of the item. As a result, the section including paragraphs 22A-22D incorporates the Consensus in SIC-23, Property, Plant and Equipment –Major Inspection or Overhaul Costs, and SIC-23 will be withdrawn.
- to amend paragraph 23 to replace the “originally assessed standard of performance” with the “standard of performance assessed immediately before the expenditure was made” as part of the criterion for determining whether subsequent expenditure relating to an item of property, plant and equipment should be capitalised. Accordingly, SIC-6, Costs of Modifying Existing Software, will be withdrawn.
- to amend paragraph 46 to require the residual value of an asset to be reviewed as at each balance sheet date, regardless of whether the asset

is measured under the benchmark treatment or the allowed alternative treatment. A change in the asset's residual value, other than a change reflected in an impairment loss recognised under IAS 36, Impairment of Assets, would be accounted for prospectively as an adjustment to future depreciation.

- to amend paragraphs 49 and 52 to clarify that the requirement to review “periodically” the useful life and depreciation method of an item of property, plant and equipment means that such reviews must occur at least at each financial year end.
- to add paragraphs 53A and 53B to specify that compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall, in the period in which it is received, be:
 - included in profit or loss for that period; and
 - disclosed separately.

Paragraphs 53A and 53B incorporate the Consensus in SIC-14, Property, Plant and Equipment – Compensation for the Impairment or Loss of Items. SIC-14 will be withdrawn.

- to include guidance in paragraph 59 that depreciation of an item of property, plant and equipment does not cease when it becomes temporarily idle or is retired from active use and held for disposal.
- to remove the exemption in paragraph 60 from disclosing comparative information for the reconciliation of the carrying amount at the beginning and end of the period for each class of property, plant and equipment.
- to remove paragraph 61(b), which requires disclosure of the accounting policy for the estimated costs of restoring the site of items of property, plant and equipment (this policy is specified in IAS 37, Provisions, Contingent Liabilities and Contingent Assets).
- to amend paragraph 64(d) and add paragraph 64(e) to require disclosure of the following for items of property, plant and equipment stated at revalued amounts:
 - the methods and significant assumptions applied in estimating the assets' fair values; and

- 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.

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International Accounting Standard IAS 16 (revised 1998 200X)

Property, Plant and Equipment

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International Accounting Standard IAS 16 (revised 1998 200X)

Property, Plant and Equipment

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

Objective

The objective of this Standard is to prescribe the accounting treatment for property, plant and equipment. The principal issues in accounting for property, plant and equipment are the timing of recognition of the assets, the determination of their carrying amounts and the depreciation charges to be recognised in relation to them.

This Standard requires an item of property, plant and equipment to be recognised as an asset when it satisfies the definition and recognition criteria for an asset in the Framework for the Preparation and Presentation of Financial Statements.

Scope

1. ***This Standard ~~should~~ shall be applied in accounting for property, plant and equipment except when another ~~International Accounting Standard~~ requires or permits a different accounting treatment.***
2. This Standard does not apply to:
 - (a) biological assets related to agricultural activity (see IAS 41, Agriculture); and
 - (b) mineral rights, the exploration for and extraction of minerals, and mineral reserves such as oil, natural gas and similar non-regenerative resources.

However, this Standard ~~does apply~~ applies to property, plant and equipment used to develop or maintain the ~~activities or assets covered described~~ in (a) ~~or~~ and (b) ~~but separable from those activities or assets.~~

3. ~~[Deleted] In some circumstances International Accounting Standards permit the initial recognition of the carrying amount of property, plant and equipment to be determined using an approach different from that prescribed in this Standard. For example, IAS 22 (revised 1998), Business Combinations, requires property, plant and equipment acquired in a business combination to be measured initially at fair value even when it exceeds cost. However, in such cases all other aspects of the accounting treatment for these assets, including depreciation, are determined by the requirements of this Standard.~~
4. ~~An enterprise applies IAS 40, Investment Property, rather than this Standard to its investment property. An enterprise entity applies this Standard to property being constructed or developed for future use as investment property, because the property does not yet satisfy the definition of 'investment property' in IAS 40, Investment Property. Once the construction or development is complete, the property becomes investment property and the enterprise entity applies IAS 40. IAS 40 also applies to existing investment property that is being redeveloped for continued future use as investment property. Using the cost model permitted for investment property under IAS 40 requires use of the benchmark treatment in this Standard.~~
5. ~~[Deleted] This Standard does not deal with certain aspects of the application of a comprehensive system reflecting the effects of changing prices (see IAS 15, Information Reflecting the Effects of Changing Prices, and IAS 29, Financial Reporting in Hyperinflationary Economies). However, enterprises applying such a system are required to comply with all aspects of this Standard, except for those that deal with the measurement of property, plant and equipment subsequent to its initial recognition.~~

Definitions

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

Property, plant and equipment are tangible assets that:

- (a) are held by an enterprise entity for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and
- (b) are expected to be used during more than one period.

Depreciation is the systematic allocation of the depreciable amount of an asset over its useful life.

Depreciable amount is the cost of an asset, or other amount substituted for cost in the financial statements, less its residual value.

Useful life is either:

- (a) the period of time over which an asset is expected to be used by the enterprise entity; or
- (b) the number of production or similar units expected to be obtained from the asset by the enterprise entity.

Cost is the amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.

The residual value of an asset is the estimated ~~net~~ amount ~~which that the enterprise entity expects to~~ would currently obtain for an from disposal of the asset, at the end of its useful life after deducting the expected estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.

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

An impairment loss is the amount by which the carrying amount of an asset exceeds its recoverable amount.

Carrying amount is the amount at which an asset is recognised ~~in the balance sheet~~ after deducting any accumulated depreciation and accumulated impairment losses ~~thereon~~.

Recognition of Property, Plant and Equipment

7. *An item of property, plant and equipment ~~should~~ shall be recognised as an asset when, and only when:
 - (a) *it is probable that future economic benefits associated with the asset will flow to the enterprise entity; and*
 - (b) *the cost of the asset ~~to the enterprise or, when the asset is carried at a revalued amount, the fair value of the asset,~~ can be measured reliably.**
8. Property, plant and equipment is often a major portion of the total assets of an ~~enterprise entity~~, and therefore is significant in the presentation of its financial position. Furthermore, the determination of whether an expenditure represents an asset or an expense can have a significant effect on an ~~enterprise's reported results of operations~~ entity's profit or loss.
9. ~~[Deleted] In determining whether an item satisfies the first criterion for recognition, an enterprise needs to assess the degree of certainty attaching to the flow of future economic benefits on the basis of the available evidence at the time of initial recognition. Existence of sufficient certainty that the future economic benefits will flow to the enterprise necessitates an assurance that the enterprise 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 enterprise. Before this occurs, the transaction to acquire the asset can usually be cancelled without significant penalty and, therefore, the asset is not recognised.~~
10. ~~[Deleted] The second criterion for recognition is usually readily satisfied because the exchange transaction evidencing the purchase of the asset identifies its cost. In the case of a self constructed asset, a reliable measurement of the cost can be made from the transactions with parties external to the enterprise for the acquisition of the materials, labour and other inputs used during the construction process.~~
11. In identifying what constitutes a separate item of property, plant and equipment, judgement is required in applying the criteria in the definition to specific circumstances or specific types of ~~enterprises~~

entities. It may be appropriate to aggregate individually insignificant items, such as moulds, tools and dies, and to apply the criteria to the aggregate value. Most spare parts and servicing equipment ~~are~~ usually are carried as inventory and recognised as an expense as consumed. However, major spare parts and stand-by equipment qualify as property, plant and equipment when the ~~enterprise~~ entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment and their use is expected to be irregular, they are accounted for as property, plant and equipment and are depreciated over a ~~time~~ period not exceeding the useful life of the related asset.

12. ~~In certain circumstances, it is appropriate to~~ An entity allocates the ~~total expenditure on~~ amount initially recognised in respect of an asset to its component parts and accounts for each component separately. ~~This is the case when the components~~ assets have different useful lives or provide benefits to the ~~enterprise~~ entity in a different pattern, ~~thus necessitating~~ In those circumstances, it is necessary to use ~~of~~ different depreciation rates and methods. For example, ~~an aircraft~~ the airframe and ~~its engines~~ of an aircraft ~~need to be~~ are treated as separate depreciable assets if they have different useful lives.
13. Property, plant and equipment may be acquired for safety or environmental reasons. The acquisition of such property, plant and equipment, ~~while~~ although not directly increasing the future economic benefits of any particular existing item of property, plant and equipment may be necessary ~~in order~~ for the ~~enterprise~~ entity to obtain the future economic benefits from its other assets. When this is the case, such acquisitions of property, plant and equipment qualify for recognition as assets, ~~in that~~ because they enable future economic benefits from related assets to be derived by the ~~enterprise~~ entity in excess of what ~~it~~ could be derived if they had not been acquired. However, ~~such assets are only recognised to the extent that~~ the resulting carrying amount of such an asset and related assets ~~does not exceed the total recoverable amount of that asset and its related assets~~ is reviewed for impairment under IAS 36, Impairment of Assets. For example, a chemical manufacturer may ~~have to~~ install ~~certain~~ new chemical handling processes ~~in order~~ to comply with environmental requirements on the production and storage of dangerous chemicals; related plant enhancements are recognised as an asset ~~to the extent~~

~~they are recoverable~~ because, without them, the ~~enterprise~~ entity is unable to manufacture and sell chemicals.

Initial Measurement of Property, Plant and Equipment

14. *An item of property, plant and equipment ~~which~~ that qualifies for recognition as an asset ~~should~~ shall initially be measured at its cost.*

Components of Cost

15. 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 any trade discounts and rebates; and
 - (b) any directly attributable costs of bringing to bring the asset to the location and working condition necessary for its intended use it to be capable of operating in the manner intended by management, including costs of testing whether the asset is functioning properly, after deducting the net proceeds from selling any items produced when bringing the asset to that location and condition (such as samples produced when testing equipment); any trade discounts and rebates are deducted in arriving at the purchase price.

15A. Examples of directly attributable costs are:

- (a) costs of employee benefits (as defined in IAS 19, Employee Benefits) arising directly from the construction or acquisition of the item of property, plant and equipment;
- (ab) ~~the~~ costs of site preparation;
- (bc) initial delivery and handling costs;
- (ed) installation and assembly costs; and
- (de) professional fees ~~such as for architects and engineers; and,~~
- (e) ~~the estimated cost of dismantling and removing the asset and restoring the site, to the extent that it is recognised as a provision~~

~~under IAS 37, Provisions, Contingent Liabilities and Contingent Assets.~~

16. When payment for an item of property, plant and equipment is deferred beyond normal credit terms, its cost is the cash price equivalent; the difference between ~~this~~ that amount and the total payments is recognised as interest expense over the period of credit unless it is capitalised in accordance with the allowed alternative treatment in IAS 23, Borrowing Costs.

16A. If an item of property, plant and equipment is acquired in exchange for equity instruments of the entity, the cost of the item of property, plant and equipment is the fair value of the equity instruments issued. The fair value of the item received is used to measure its cost if it is more clearly evident than the fair value of the equity instruments issued.

17. ~~Administration and other general overhead costs~~ Examples of costs that are not a component of the cost of property, plant and equipment are: ~~unless they can be directly attributed to the acquisition of the asset or bringing the asset to its working condition. Similarly, start up and similar pre production costs do not form part of the cost of an asset unless they are necessary to bring the asset to its working condition.~~

(a) costs of opening a new facility;

(b) costs of introducing a new product or service (including costs of advertising and promotional activities);

(c) costs of conducting business in a new location or with a new class of customer (including costs of staff training); and

(d) administration and other general overhead costs.

These costs are excluded because they are not a part of the asset's purchase price, and cannot be attributed directly to bringing the asset to the location and working condition necessary for it to be capable of operating in the manner intended by management.

17A. Because capitalisation of costs ceases when an item of property, plant and equipment is in the location and working condition necessary for it to be capable of operating in the manner intended by management, costs incurred in using or redeploying assets (as distinct from improving the assets' standard of performance) are excluded from the

cost of those assets. For example, the following costs are excluded from the cost of property, plant and equipment:

- (a) costs incurred while assets capable of operating in the manner intended by management have yet to be brought into use or are operated at less than full capacity;
- (b) initial operating losses, such as those incurred prior to an asset achieving planned performance while demand for the assets' outputs builds up; are recognised as an expense, and
- (c) costs of relocating or reorganising part or all of the entity's operations.

17B. 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 asset to the location and working 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, income may be earned through using a building site as a car park until construction commences. Because incidental operations are not necessary to bring an asset to the location and working condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss for the period, and included in their respective classifications of income and expense in the income statement.

- 18. The cost of a self-constructed asset is determined using the same principles as for an acquired asset. If an enterprise entity makes similar assets for sale in the normal course of business, the cost of the asset is usually the same as the cost of producing the assets for sale (see IAS 2, Inventories). Therefore, any internal profits are eliminated in arriving at such costs. Similarly, the cost of abnormal amounts of wasted material, labour, or other resources incurred in the production of a self-constructed asset is not included in the cost of the asset. IAS 23 establishes criteria which that need to be satisfied before interest costs can be recognised as a component cost of property, plant and equipment cost.
- 19. The cost of an asset held by a lessee under a finance lease is determined using the principles set out in IAS 17, Leases.

20. The carrying amount of property, plant and equipment may be reduced by applicable government grants in accordance with IAS 20, Accounting for Government Grants and Disclosure of Government Assistance.

Costs to dismantle and remove an asset and restore its site

20A. The cost of an item of property, plant and equipment under paragraph 15 includes the costs of dismantling and removing the asset and restoring the site on which that asset is located. Those costs may be incurred when the asset is initially acquired or in subsequent periods, and in either case are depreciated over the remainder of the asset's useful life. They are measured in accordance with IAS 37, Provisions, Contingent Liabilities and Contingent Assets.

20B. In those situations in which the asset to be measured is land, the costs referred to in paragraph 20A are depreciated over the period of benefits 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 to be derived from it.

Exchanges of Assets

21. An item of property, plant and equipment may be acquired in exchange or part exchange for ~~a dissimilar~~ another item of property, plant and equipment or other asset. Except when paragraph 21A applies, the cost of such an item is measured at the fair value of the asset received, which is equivalent to the fair value of the asset given up, adjusted by the amount of any cash or cash equivalents transferred. The fair value of the asset received is used to measure its cost if it is more clearly evident than the fair value of the asset given up.

21A. The cost of an item of property, plant and equipment acquired in exchange for a similar asset is measured at the carrying amount of the asset given up when the fair value of neither of the assets exchanged can be determined reliably. The entity will be unable to determine reliably the fair value of an item of property, plant and equipment when comparable market transactions are infrequent and alternative estimates of fair value (for example, based on discounted cash flow projections) cannot be calculated.

22. ~~[Deleted] An item of property, plant and equipment may be acquired in exchange for a similar asset that has a similar use in the same line of business and which has a similar fair value. An item of property, plant and equipment may also be sold in exchange for an equity interest in a similar asset. In both cases, since the earnings process is incomplete, no gain or loss is recognised on the transaction. Instead, the cost of the new asset is the carrying amount of the asset given up. However, the fair value of the asset received may provide evidence of an impairment in the asset given up. Under these circumstances the asset given up is written down and this written down value assigned to the new asset. Examples of exchanges of similar assets include the exchange of aircraft, hotels, service stations and other real estate properties. If other assets such as cash are included as part of the exchange transaction this may indicate that the items exchanged do not have a similar value.~~

Replacing or Renewing a Component

22A. Expenditure incurred in replacing or renewing a component of an item of property, plant and equipment shall be accounted for as the acquisition of a separate asset, and the carrying amount of the replaced or renewed component asset shall be written off.

~~27~~22B. [Paragraph moved ahead of former paragraph 23] Major components of some items of property, plant and equipment may require replacement at regular intervals. For example, a furnace may require relining after a specified number of hours of usage, or aircraft interiors such as seats and galleys may require replacement several times during the life of the airframe. The components are accounted for as separate assets because they have useful lives different from those of the items of property, plant and equipment to which they relate. Therefore, provided the recognition criteria in paragraph 7 are satisfied, the expenditure incurred in replacing or renewing the component is accounted for as the acquisition of a separate asset and the carrying amount of the replaced asset is written off.

22C. A condition of continuing to operate some items of property, plant and equipment (for example, an aircraft) is performing regular major inspections for faults regardless of whether components of the item are replaced. The costs of a major inspection of an item of property, plant and equipment may be a separate component of the cost of that item.

In these circumstances, when each major inspection is performed, its cost is capitalised as a replacement component if the recognition criteria in paragraph 7 are satisfied, and any remaining carrying amount of the replaced component (the inspection component, as distinct from physical components) is written off.

- 22D. A separate component may be identified in respect of a major inspection regardless of whether the component was invoiced separately or identified specifically in the transaction in which the item was acquired or constructed. When necessary, the estimated cost of a future similar inspection may be used as an indication of the cost of the existing inspection component when the item was acquired or constructed.

Subsequent Expenditure

23. *Subsequent expenditure relating to an item of property, plant and equipment that has ~~already~~ been recognised, other than expenditure incurred in replacing or renewing a component of such an item, ~~should~~ shall be added to the carrying amount of the asset when, and only when, it is probable that the expenditure increases the future economic benefits, embodied in the asset in excess of the originally assessed ~~its~~ standard of performance ~~of the existing asset, will flow to the enterprise~~ assessed immediately before the expenditure was made.*

- 23A. All ~~other~~ subsequent expenditure that fails the criteria for capitalisation in paragraphs 22A and 23 ~~should~~ shall be recognised as an expense in the period in which it is incurred.

- 23B. Expenditure incurred in replacing or renewing a component of an item of property, plant and equipment is accounted for as the acquisition of a separate asset under paragraph 22A, and is not 'subsequent expenditure' relating to an item of property, plant and equipment.

24. Examples of subsequent expenditure on property, plant and equipment is ~~only recognised as an asset when the expenditure improves the condition of the asset beyond its originally assessed standard of performance. Examples of improvements which that results in increased future economic benefits include:~~

- (a) modification of an item of plant to extend its remaining useful life, ~~including an or to~~ increase in its capacity;
- (b) upgrading machine parts to achieve a substantial improvement in the quality of output; and
- (c) ~~adoption~~ development of a new production ~~processes~~ process enabling a substantial reduction in ~~previously assessed~~ operating costs.

~~2625.~~ The appropriate accounting treatment for ~~Whether~~ expenditure incurred subsequent to the acquisition of an item of property, plant and equipment increases the future economic benefits embodied in the asset depends on the circumstances which were taken into account on the initial measurement and recognition of the related item of property, plant and equipment in assessing the asset's standard of performance (including the level of maintenance assumed in the most recent estimate of its useful life) immediately before the expenditure and whether the subsequent expenditure is recoverable. For ~~instance~~ example, when the carrying amount of the item of property, plant and equipment ~~already takes into account a loss in economic benefits, has been written down to recognise an impairment,~~ the subsequent expenditure ~~to restore the future economic benefits expected from the asset is capitalised to the extent that it causes the impairment loss to be reversed provided that the carrying amount does not exceed the recoverable amount of the asset.~~ This is also the case Subsequent expenditure also is capitalised when the purchase price of an asset already reflects the ~~enterprise's obligation~~ entity's need to incur ~~that expenditure in the future which is necessary to bring the asset to its working condition.~~ An example of this ~~might be~~ is the acquisition of a building requiring renovation. In such circumstances, the subsequent expenditure is added to the ~~asset's carrying amount of the asset to the extent that it can be recovered from future use of the asset.~~

~~2526.~~ [Former paragraph 25 moved] Expenditure on ~~repairs or maintenance immaterial replacements or renewals~~ of property, plant and equipment ~~is made to restore or maintain the future economic benefits that an enterprise can expect from the originally assessed standard of performance of the asset. As such, it is usually~~ may be treated as repairs and recognised as an expense when incurred ~~for example, the cost of servicing or overhauling plant and equipment is usually an expense since it restores, rather than increases, the originally assessed standard of performance.~~

27. [This paragraph now is paragraph 22B.]

Measurement Subsequent to Initial Recognition

Benchmark Treatment

28. *Subsequent to initial recognition as an asset, an item of property, plant and equipment ~~should~~ shall be carried at its cost less any accumulated depreciation and any accumulated impairment losses.*

Allowed Alternative Treatment

29. *Subsequent to initial recognition as an asset, an item of property, plant and equipment ~~should~~ 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 ~~should~~ shall be made with sufficient regularity ~~such~~ that the carrying amount does not differ materially from that which would be determined using fair value at the balance sheet date.*

Revaluations

30. The fair value of land and buildings is usually its market value. This value is determined by appraisal normally undertaken by professionally qualified valuers.
31. The fair value of items of plant and equipment is usually their market value determined by appraisal. When there is no evidence of market value because of the specialised nature of the plant and equipment and because these items are rarely sold, except as part of a continuing business, they are valued at their depreciated replacement cost.
32. The frequency of revaluations depends upon the movements 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 may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such

frequent revaluations are unnecessary for items of property, plant and equipment with only insignificant movements in fair value. Instead, revaluation every three or five years may be sufficient.

33. When an item of property, plant and equipment is revalued, any accumulated depreciation at the date of the revaluation is either:
- (a) restated proportionately with the change in the gross carrying amount of the asset so that the carrying amount of the asset after revaluation equals its revalued amount. This method is often used when an asset is revalued by means of applying an index to its depreciated replacement cost; or
 - (b) eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset. For example, this method is often used for buildings ~~which~~ that are revalued to their market value.

The amount of the adjustment arising on the restatement or elimination of accumulated depreciation forms part of the increase or decrease in carrying amount ~~which~~ that is dealt with in accordance with paragraphs 37 and 38.

34. ***When an item of property, plant and equipment is revalued, the entire class of property, plant and equipment to which that asset belongs ~~should~~ shall be revalued.***
35. A class of property, plant and equipment is a grouping of assets of a similar nature and use in an ~~enterprise's~~ entity's operations. The following are examples of separate classes:
- (a) land;
 - (b) land and buildings;
 - (c) machinery;
 - (d) ships;
 - (e) aircraft;
 - (f) motor vehicles;
 - (g) furniture and fixtures; and
 - (h) office equipment.

36. 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 ~~which~~ 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 of time and provided the revaluations are kept up to date.
37. *When an asset's carrying amount is increased as a result of a revaluation, the increase ~~should~~ shall be credited directly to equity under the heading of revaluation surplus. ~~However, except that, to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense, a revaluation increase should it shall be recognised as income to the extent that it reverses a revaluation decrease of the same asset previously recognised as an expense.~~*
38. *When an asset's carrying amount is decreased as a result of a revaluation, the decrease ~~should~~ shall be recognised as an expense. ~~However, a revaluation decrease should be charged debited directly against any related credit balance existing in the revaluation surplus in respect of that asset and, to the extent that the decrease does not exceed the amount held in the revaluation surplus in respect of that same asset exceeds that credit balance, it shall be recognised as an expense.~~*
39. The revaluation surplus included in equity in respect of an item of property, plant and equipment may be transferred directly to retained earnings when the ~~surplus is realised~~ asset is derecognised (that is, eliminated from the balance sheet). This may involve transferring the whole ~~of the surplus may be realised on the retirement or disposal of the~~ when the asset is retired or disposed of. However, some of the surplus may be ~~realised transferred~~ transferred as the asset is used by the ~~enterprise entity~~; in such a case, the amount of the surplus ~~realised is transferred would be~~ the difference between depreciation based on the revalued carrying amount of the asset and depreciation based on the asset's original cost. ~~The~~ Transfers from revaluation surplus to retained earnings ~~is~~ are not made through the income statement.
40. The effects on taxes on income, if any, resulting from the revaluation of property, plant and equipment are ~~dealt with in~~ recognised and disclosed in accordance with IAS 12, Income Taxes.

Depreciation

41. *The depreciable amount of an item of property, plant and equipment ~~should~~ shall be allocated on a systematic basis over its useful life. The depreciation method used ~~should~~ shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the enterprise entity. The depreciation charge for each period ~~should~~ shall be recognised as an expense unless it is included in the carrying amount of another asset.*
42. As the future economic benefits embodied in an asset are consumed by the enterprise entity, the carrying amount of the asset is reduced to reflect this consumption, normally by ~~charging~~ recognising an expense for depreciation. A Depreciation ~~charge is made~~ is recognised even if the value of the asset exceeds its carrying amount.
43. The future economic benefits embodied in an item of property, plant and equipment are consumed by the enterprise 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 that might have been expected to be available obtained from the asset. Consequently, all the following factors ~~need to be~~ are considered in determining the useful life of an asset:
- (a) the expected usage of the asset by the enterprise entity. Usage is assessed by reference to the asset's expected capacity or physical output;
 - (b) the expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme of the enterprise entity, 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; and
 - (d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.
44. The useful life of an asset is defined in terms of the asset's expected utility to the enterprise entity. The asset management policy of an

enterprise entity may involve the disposal of assets after a specified time or after consumption of a certain proportion of the future economic benefits 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 an item of property, plant and equipment is a matter of judgement based on the experience of the enterprise entity with similar assets.

45. Land and buildings are separable assets and are dealt with separately for accounting purposes, even when they are acquired together. With certain exceptions, such as quarries and sites used for landfill, land ~~normally~~ 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 useful life of the building.
46. The depreciable amount of an asset is determined after deducting the residual value of the asset. In practice, the residual value of an asset is often insignificant and therefore is immaterial in the calculation of the depreciable amount. When ~~the benchmark treatment is adopted and~~ the residual value is likely to be significant material, the residual value is estimated at the date of acquisition and is ~~not subsequently increased for changes in prices~~ reviewed as at each balance sheet date. A change in the asset's residual value, other than a change reflected in an impairment loss recognised under IAS 36, Impairment of Assets, is accounted for prospectively as an adjustment to future depreciation. ~~However, when the allowed alternative treatment is adopted, a new estimate is made at the date of any subsequent revaluation of the asset. The~~ An estimate of an asset's residual value is based on the ~~residual value prevailing~~ amount recoverable from disposal, at the date of the estimate, ~~for of~~ similar assets which that have reached the end of their useful lives and ~~which~~ have operated under conditions similar to those in which the asset will be used.
47. 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 sum-of-the-units method. Straight-line depreciation results in a constant charge over the useful life of the asset. The diminishing balance method results in a decreasing charge over the useful life of the asset. The sum-of-the-units method results in a charge based on the expected use or output of the asset. The method used for an asset is selected based on the expected pattern of

consumption of the future economic benefits embodied in the asset, and is consistently applied consistently from period to period unless there is a change in the expected pattern of consumption of those future economic benefits from that asset.

48. The depreciation charge for a period ~~is~~ usually is recognised as an expense. However, in some circumstances, the future economic benefits embodied in an asset are absorbed by the enterprise entity in producing other assets, rather than giving rise to an expense. In this case, the depreciation charge ~~comprises~~ 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 IAS 2, Inventories). Similarly, depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset ~~that is~~ recognised under IAS 38, Intangible Assets.

Review of Useful Life

49. *The useful life of an item of property, plant and equipment ~~should~~ shall be reviewed periodically at least at each financial year end and, if expectations of useful life are significantly different from previous estimates, the depreciation charge rate for the current and future periods ~~should~~ shall be adjusted.*
50. During the life of an asset it may become apparent that the estimate of ~~the~~ useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure on the asset ~~which that~~ improves the condition of the asset ~~beyond its originally assessed standard of performance.~~ Alternatively, technological changes or changes in the market for the products may reduce the useful life of the asset. In such cases, the useful life and, therefore, the depreciation rate ~~is~~ are adjusted for the current and future periods.
51. The repair and maintenance policy of the enterprise entity may also affect the useful life of an asset. The policy may result in an extension of the useful life of the asset or an increase in its residual value. However, the adoption of such a policy does not negate the need to ~~charge~~ recognise depreciation.

Review of Depreciation Method

52. *The depreciation method applied to property, plant and equipment ~~should~~ shall be reviewed ~~periodically~~ at least at each financial year end and, if there has been a significant change in the expected pattern of consumption of the future economic benefits ~~from embodied in~~ those assets, the method ~~should~~ shall be changed to reflect the changed pattern. When such a change in depreciation method is necessary, the change ~~should~~ shall be accounted for as a change in an accounting estimate and the depreciation charge for the current and future periods ~~should~~ shall be adjusted.*

52A. A change in the depreciation method is a change in the technique used to apply the entity's accounting policy to recognise depreciation as an asset's future economic benefits are consumed. Therefore, it is a change in an accounting estimate.

Recoverability of the Carrying Amount – Impairment Losses

53. To determine whether an item of property, plant and equipment is impaired, an ~~enterprise~~ entity applies IAS 36, Impairment of Assets. That Standard explains how an ~~enterprise~~ entity reviews the carrying amount of its assets, how it determines the recoverable amount of an asset, and when it recognises or reverses an impairment loss.[†]

Compensation for Impairments, and Related Replacements

53A. Compensation from third parties for items of property, plant and equipment that were impaired, lost or given up shall, in the period in which it is received, be:

(a) included in profit or loss for that period; and

(b) disclosed separately on the face of the income statement or in the notes.

[†]— See also SIC 14, Property, Plant and Equipment – Compensation for the Impairment or Loss of Items.

53B. 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 recognised under IAS 36; retirements or disposals of items of property, plant and equipment are recognised under paragraphs 55-59 of this Standard; s
- (b) compensation from third parties for items of property, plant and equipment that were impaired, lost or given up is included in determining profit or loss for the period in which it is received; and
- (c) the cost of assets restored, purchased or constructed as a replacement is determined under paragraphs 14-20A and paragraphs 22A-22D of this Standard.

Business Combinations

54. IAS 22, Business Combinations, explains how to deal with an impairment loss recognised before the end of the first annual accounting period ~~commencing~~ beginning after a business combination that is an acquisition.

Retirements and Disposals

55. *An item of property, plant and equipment ~~should~~ shall be eliminated from the balance sheet derecognised on:*

(a) disposal; or

(b) when the asset is permanently withdrawn from use and no future economic benefits are expected from its use or disposal.

56. *Gains or losses arising from the retirement or disposal of an item of property, plant and equipment ~~should~~ shall be determined as the difference between the ~~estimated~~ net disposal proceeds and the carrying amount of the asset ~~and should be recognised as income or expense in the income statement.~~ They shall be included in profit or*

loss for the period in which the retirement or disposal occurs (unless IAS 17, Leases, requires otherwise on a sale and leaseback).

57. ~~[Deleted] When an item of property, plant and equipment is exchanged for a similar asset, under the circumstances described in paragraph 22, the cost of the acquired asset is equal to the carrying amount of the asset disposed of and no gain or loss results.~~
58. The disposal of an item of property, plant and equipment may occur by sale or by entering into a finance lease. In determining the date of disposal of such an item, an entity applies the criteria in IAS 18, Revenue, for recognising revenue from the sale of goods. IAS 17, Leases, applies to a disposal by a sale and leaseback transactions are accounted for in accordance with IAS 17, Leases.
- 58A. The consideration receivable on disposal of an item of property, plant and equipment is recognised initially at fair value. If payment for such an item is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue under IAS 18 according to the effective yield on the receivable.
59. Depreciation of an item of property, plant and equipment that does not cease when it becomes temporarily idle or is retired from active use and held for disposal is carried at its carrying amount at the date when the asset is retired from active use, unless the asset's depreciable amount has been allocated fully. At least at each financial year end, an enterprise entity tests the such an asset for impairment under IAS 36, Impairment of Assets, and recognises any impairment loss accordingly.

Disclosure

60. *The financial statements ~~should~~ shall disclose, for each class of property, plant and equipment:*
- (a) *the measurement bases used for determining the gross carrying amount. When more than one basis has been used for a class, the gross carrying amount for ~~that each~~ each basis ~~in each category adopted within the class should~~ shall be disclosed;*
- (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;*
- (e) *a reconciliation of the carrying amount at the beginning and end of the period showing:*
 - (i) *additions;*
 - (ii) *disposals;*
 - (iii) *acquisitions through business combinations;*
 - (iv) *increases or decreases during the period resulting from revaluations under paragraphs 29, 37 and 38 and from impairment losses recognised or reversed directly in equity under IAS 36, Impairment of Assets (if any);*
 - (v) *impairment losses recognised in the income statement during the period under IAS 36 (if any);*
 - (vi) *impairment losses reversed in the income statement during the period under IAS 36 (if any);*
 - (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 entity operation into the presentation currency of the reporting entity; and*
 - (ix) *other movements.*

~~Comparative information is not required for the reconciliation in (e) above.~~

61. The financial statements ~~should~~ shall also disclose:

- (a) *the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;*
- ~~(b) the accounting policy for the estimated costs of restoring the site of items of property, plant or equipment;~~

(eb) the amount of expenditures ~~on account~~ capitalised in respect of property, plant and equipment in the course of construction; and

(dc) the amount of contractual commitments for the acquisition of property, plant and equipment.

62. ~~The~~ Selection of the depreciation method and ~~the~~ estimation of the useful life of assets are matters of judgement. Therefore, disclosure of the methods adopted and the estimated useful lives or depreciation rates provides users of financial statements with information ~~which~~ that allows them to review the policies selected by management and enables comparisons to be made with other ~~enterprises~~ entities. For similar reasons, it is necessary to disclose:

(a) ~~the~~ depreciation allocated, whether recognised as an expense or as a part of the cost of other assets, in during a period; and

(b) ~~the~~ accumulated depreciation at the end of that period.

63. An ~~enterprise~~ entity discloses the nature and effect of a change in an accounting estimate that has ~~a material~~ an effect in the current period or ~~which~~ is expected to have ~~a material~~ an effect in subsequent periods in accordance with IAS 8, ~~Net Profit or Loss for the Period, Fundamental Errors and Accounting Policies, Changes in Accounting Policy Estimates and Errors~~. Such disclosure may arise from changes in estimate with respect to:

(a) residual values;

(b) the estimated costs of dismantling, ~~and~~ removing or restoring items of property, plant ~~or~~ and equipment ~~and restoring the site;~~

(c) useful lives; and

(d) depreciation method.

64. *When items of property, plant and equipment are stated at revalued amounts the following ~~should~~ shall be disclosed:*

(a) the basis used to revalue the assets;

(b) the effective date of the revaluation;

(c) whether an independent valuer was involved;

- (d) ~~*the nature of any indices used to determine replacement cost the methods and significant assumptions applied in estimating the assets' fair values;*~~
- (e) ~~*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;*~~
- (ef) ~~*the carrying amount of for each revalued class of property, plant and equipment, the carrying amount that would have been included in the financial statements recognised had the assets been carried under the benchmark treatment in paragraph 28; and*~~
- (fg) ~~*the revaluation surplus, indicating the movement for the period and any restrictions on the distribution of the balance to shareholders.*~~

65. An ~~enterprise~~ entity discloses information on impaired property, plant and equipment under IAS 36, Impairment of Assets, in addition to the information required by paragraph 60(e)(iv)-(vi).
66. Financial statement users 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 benchmark treatment is used, the fair value of property, plant and equipment when this is materially different from the carrying amount.

Therefore, ~~enterprises~~ entities are encouraged to disclose these amounts.

Transitional Provisions

66A. The amendments to the initial measurement of assets acquired in exchanges of assets specified in paragraphs 21 and 21A shall be applied prospectively.

66B. If an exchange of assets was measured on the basis of the carrying amount of the asset given up under paragraph 22 of IAS 16 (revised 1998), the entity does not restate the carrying amount of the asset acquired to reflect the fair value of the consideration given. Therefore, on adoption of this Standard, an entity does not apply the general treatment of changes in accounting policies in IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Effective Date

~~67. This International Accounting Standard becomes operative for annual financial statements covering periods beginning on or after 1 July 1999 1 January 2003. Earlier application adoption is encouraged. If an enterprise applies this Standard for annual financial statements covering periods beginning before 1 July 1999, If earlier adoption affects the financial statements, the enterprise should an entity shall disclose that fact.:~~

~~(a) disclose that fact; and~~

~~(b) adopt IAS 22 (revised 1998), Business Combinations, IAS 36, Impairment of Assets, and IAS 37, Provisions, Contingent Liabilities and Contingent Assets, at the same time.~~

~~68. [Deleted] This Standard supersedes IAS 16, Property, Plant and Equipment, approved in 1993.~~

Appendix

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 16. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to accounting for property, plant and equipment established by IAS 16, this Basis for Conclusions does not discuss requirements in IAS 16 that the Board has not reconsidered.

Exchanges of similar items of property, plant and equipment

- A3. Paragraph 22 of IAS 16 indicates that if:
- (a) an item of property, plant and equipment is acquired in exchange for a similar asset that has a similar use in the same line of business and which has a similar fair value; or
 - (b) an item of property, plant and equipment is sold in exchange for an equity interest in a similar asset;
- no gain or loss is recognised on the transaction, and the cost of the new asset is the carrying amount of the asset given up (rather than the fair value of the purchase consideration given for the new asset).
- A4. This requirement in IAS 16 is consistent with views that:
- (a) gains should not be recognised on exchanges of assets unless the exchanges represent the culmination of an earning process;

- (b) exchanges of assets of a similar nature and value are not a substantive event warranting the recognition of gains; and
 - (c) requiring or permitting the recognition of gains from such exchanges enables entities to 'manufacture' gains by attributing inflated values to the assets exchanged, when the assets do not have observable market prices in active markets.
- A5. The approach described above raised issues about how to identify whether assets exchanged are similar in nature and value. The Board reviewed this topic, and noted views that:
- (a) under the Framework for the Preparation and Presentation of Financial Statements, the recognition of income from an exchange of assets does not depend on whether the assets exchanged are dissimilar;
 - (b) income is not necessarily earned only at the culmination of an earning process, and in some cases it is arbitrary to determine when an earning process culminates;
 - (c) generally, under both measurement bases subsequent to initial recognition that are permitted under IAS 16, gain recognition is not deferred beyond the date at which assets are exchanged; and
 - (d) removing 'existing carrying amount' measurement of property, plant and equipment acquired in exchange for similar assets would increase the consistency of measurement of acquisitions of assets.
- A6. The Board decided:
- (a) to require in IAS 16 that all exchanges of items of property, plant and equipment are measured at fair value, except that, when the fair value of neither of the assets exchanged can be determined reliably, the cost of the asset acquired in the exchange is measured at the carrying amount of the asset given up; and
 - (b) to amend IAS 38, Intangible Assets, to include similar requirements for exchanges of intangible assets.
- A7. The Board noted that the 'reliable measurement' test for using fair value to measure these exchanges should minimise the risk that entities could 'manufacture' gains by attributing inflated values to the assets exchanged.

- A8. The Board decided to retain the prohibition in IAS 18, Revenue, on recognising revenue from exchanges or swaps of goods or services of a similar nature and value. The Board has included a project on the Recognition of Revenue in its work programme and does not propose to make any significant amendments to IAS 18 until that project is completed.

Depreciation of assets that are temporarily idle or retired from active use and held for disposal

- A9. The Board proposes to specify in paragraph 59 that depreciation of an item of property, plant and equipment does not cease when it becomes temporarily idle or is retired from active use and held for disposal, unless the asset's depreciable amount has been allocated fully.
- A10. Some Board members argued that depreciation of an item of property, plant and equipment should cease when the item is held for sale. They also argued that an item of property, plant and equipment held for sale should be measured at the lower of its carrying amount and fair value less cost to sell. Their primary reason for these views is that the carrying amount of an asset held for sale will be recovered principally through sale rather than future operations, and therefore accounting for the asset should be a process of valuation rather than allocation.
- A11. The Board concluded that it is inappropriate to cease depreciating an asset with a limited useful life because the financial statements would omit the consumption of the asset's service potential that occurs while the asset continues to be held. The Board also concluded that requiring assets held for sale to be measured at the lower of their carrying amount and fair value less cost to sell would be a fundamental measurement change and therefore beyond the scope of the Improvements project. The Board noted that adopting the policies described in paragraph A10 would cause divergence from the standards on property, plant and equipment of most of the Board's liaison standard setters.

Current research on revaluation issues

- A12. The Board is participating in research activities with liaison standard setters on issues concerning revaluations of property, plant and equipment. This research is intended to increase international

convergence of standards dealing with revaluations. One of the most important issues being addressed is identifying the preferred measurement attribute for revaluations. This research could lead to future proposals for amendment of IAS 16.

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

Leases

International Accounting Standard IAS 17

(revised 200X)

Leases

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

Invitation to Comment

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

Question 1

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

Question 2

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

Summary of Main Changes

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

The main changes proposed are:

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

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

Leases

[Marked-up text]

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

Marked-up text

Scope

[Amend paragraph 1]

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

Definitions

[Amend paragraph 3]

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

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

Gross investment in the lease is the aggregate of:

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

Unearned finance income is the difference between:

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

- (b) the present value of (a) above, at the interest rate implicit in the lease.*

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

The interest rate implicit in the lease is the discount rate that, at the inception of the lease, causes the aggregate present value of (a) the minimum lease payments and (b) the unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset and (ii) any initial direct costs.

Classification of Leases

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

11. Leases of land and of land and buildings are classified as operating or finance leases in the same way as leases of other assets. However, a characteristic of land is that it normally has an indefinite economic life and, if title is not expected to pass to the lessee by the end of the lease term, the lessee does not receive substantially all of the risks and rewards incident to ownership. A payment made on entering into or acquiring such a leasehold represents pre-paid lease payments which are amortised over the lease term in accordance with the pattern of benefits provided.

11A. For a lease of both land and buildings, the land and buildings elements are considered separately for the purposes of lease classification, unless title to both elements is expected to pass to the lessee by the end of the lease term. When the land has an indefinite economic life, the land element is classified as an operating lease unless title is expected to pass to the lessee by the end of the lease term, in accordance with paragraph 11 of this Standard. The buildings element is classified as a finance or operating lease in accordance with paragraphs 3-10 of this Standard.

11B. The minimum lease payments at the inception of a lease of land and buildings (including any up-front payments) are allocated between the land and the buildings elements in proportion to their relative fair values at the inception of the lease. If the lease payments cannot be allocated reliably between these two elements, the entire lease is classified as a finance lease, unless it is clear that both elements are

operating leases (for the buildings elements, this may be the case for example when none of the situations in paragraphs 8 and 9 above exists), in which case the entire lease is classified as an operating lease.

11C. For a lease of land and buildings in which the value of the land element at the inception of the lease is immaterial, the land and buildings may be treated as a single unit for the purpose of lease classification and classified as a finance or operating lease in accordance with paragraphs 3-10 of this Standard. In such a case, the economic life of the buildings is regarded as the economic life of the entire leased asset.

Leases in the Financial Statements of Lessors

Finance Leases

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

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

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

Operating Leases

[Amend paragraph 44]

41. *Lessors ~~should~~ shall present assets subject to operating leases in their balance sheets according to the nature of the asset.*
42. *Lease income from operating leases ~~should~~ shall be recognised in income on a straight line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.³*
43. Costs, including depreciation, incurred in earning the lease income are recognised as an expense. Lease income (excluding receipts for services provided such as insurance and maintenance) is recognised in

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

income on a straight line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

44. Initial direct costs incurred ~~specifically to earn revenues from an operating lease are either deferred and allocated to income over the lease term in proportion to the recognition of rent income, or are recognised as an expense in the income statement in the period in which they are incurred.~~ by lessors in negotiating and arranging an operating lease are added to the carrying amount of the leased asset and recognised as an expense over the lease term on the same basis as the lease income. Initial direct costs include commissions, legal fees and those internal costs that are incremental and directly attributable to negotiating and arranging the lease.

Effective Date

[Amend paragraph 59, add new paragraph 59A]

59. ~~*This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1999. If an enterprise applies this Standard for financial statements covering periods beginning before 1 January 1999, the enterprise should disclose the fact that it has applied this Standard instead of IAS 17, Accounting for Leases, approved in 1982.*~~

- 59A. The amendments to paragraphs 3, 11-11C, 28-29A, 33, 34, 38 and 41-44 become operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact.

Appendix

Basis for Conclusions (Revisions 200X)

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

Leases of land and buildings

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

contract. Lastly, it converges with requirements in Australia, Canada and the United States.

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

Lessors' initial direct costs

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

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

and, in the same period, recognising an equal amount of unearned finance income.

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

**Proposed Improvements to
International Accounting Standard IAS 21**
(revised 1993)

**The Effects of
Changes in Foreign Exchange Rates**

International Accounting Standard IAS 21
(revised 200X)

The Effects of
Changes in Foreign Exchange Rates

Invitation to Comment

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

Question 1

Do you agree with the proposed definition of functional currency as “the currency of the primary economic environment in which the entity operates” and the guidance proposed in paragraphs 7-12 on how to determine what is an entity’s functional currency?

Question 2

Do you agree that a reporting entity (whether a group or a stand-alone entity) should be permitted to present its financial statements in any currency (or currencies) that it chooses?

Question 3

Do you agree that all entities should translate their financial statements into the presentation currency (or currencies) using the same method as is required for translating a foreign operation for inclusion in the reporting entity’s financial statements (see paragraphs 37 and 40)?

Question 4

Do you agree that the allowed alternative to capitalise certain exchange differences in paragraph 21 of IAS 21 should be removed?

Question 5

Do you agree that

- (a) goodwill and
- (b) fair value adjustments to assets and liabilities

that arise on the acquisition of a foreign operation should be treated as assets and liabilities of the foreign operation and translated at the closing rate (see paragraph 45)?

Summary of Main Changes

The following main changes are proposed:

- to remove from the scope of IAS 21 foreign currency derivatives that are within the scope of IAS 39, Financial Instruments: Recognition and Measurement.
- to replace the notion of ‘reporting currency’ in IAS 21 with two notions: functional currency (the currency in which the entity measures the items in its financial statements) and presentation currency (the currency in which the entity presents its financial statements). The term ‘functional currency’ is used in place of ‘measurement currency’ (the term used in SIC-19, Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29) since it is the more commonly used term, but with essentially the same meaning.
- to require each entity—whether a stand-alone entity, a parent of a group, or an operation within a group (such as a subsidiary, associate or branch)—to determine its functional currency and measure its results and financial position in that currency. The Board proposes to define functional currency as “the currency of the primary economic environment in which the entity operates”; and to incorporate into IAS 21 some of the guidance in SIC-19 on how to determine a measurement currency. The Board also proposes to give greater emphasis to the currency of the economy that determines the pricing of transactions than to the currency in which transactions are denominated. As a result of these proposals:
 - an entity (whether a stand-alone entity or an operation within a group) would not have a free choice of functional currency.
 - an entity could not avoid restatement under IAS 29, Financial Reporting in Hyperinflationary Economies, by, for example, adopting a stable currency (such as the functional currency of its parent) as its functional currency.
- to revise the provisions in IAS 21 on distinguishing between foreign operations that are integral to the operations of the reporting entity (referred to below as ‘integral foreign operations’) and foreign entities,

to become part of the indicators of what is an entity's functional currency. As a result:

- there is no distinction between integral foreign operations and foreign entities. Rather, an entity that was previously classified as an integral foreign operation will have the same functional currency as the reporting entity.
 - only one translation method is needed for foreign operations—namely that previously described in IAS 21 as applying to foreign entities.
 - paragraphs 23-29 of IAS 21—which deal with the distinction between an integral foreign operation and a foreign entity and specify the translation method to be used for the former—have been deleted.
- to remove the allowed alternative treatment in IAS 21, paragraph 21, to capitalise certain exchange differences.
 - to replace paragraphs 39 and 40 of IAS 21 on changes in the classification of a foreign operation (which are now redundant) with a new requirement that a change in functional currency is accounted for prospectively.
 - to require goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity to be treated as part of the assets and liabilities of the acquired entity and translated at the closing rate.
 - to move the material on hedging in IAS 21 to IAS 39, Financial Instruments: Recognition and Measurement.
 - to permit a reporting entity (whether a group or a stand-alone entity) to present its financial statements in any currency (or currencies) that it chooses.
 - to require an entity (whether a stand-alone entity, a parent of a group, or an operation within a group) to translate its results and financial position from its functional currency into the presentation currency (or currencies) using the same method as IAS 21 requires for translating a foreign operation for inclusion in the reporting entity's financial statements.
 - to require comparative amounts to be translated as follows:

- (a) for an entity whose functional currency is *not* the currency of a hyperinflationary economy:
- (i) assets and liabilities in the comparative balance sheet are translated at the closing rate at the date of that balance sheet (ie last year's comparatives are translated at last year's closing rate).
 - (ii) income and expense items in the comparative income statement are translated at exchange rates at the dates of the transactions (ie last year's comparatives are translated at last year's actual or average rate).
- (b) for an entity whose functional currency *is* the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into the currency of a hyperinflationary economy, all amounts (both balance sheet and income statement items) are translated at the closing rate of the most recent balance sheet presented (ie last year's comparatives, as adjusted for subsequent changes in the price level, are translated at this year's closing rate).
- (c) for an entity whose functional currency *is* the currency of a hyperinflationary economy, and for which the comparative amounts are being translated into the currency of a non-hyperinflationary economy, all amounts are those presented in the prior year financial statements (ie not adjusted for either subsequent changes in the price level or subsequent changes in exchange rates).

This translation method would apply both when translating the financial statements of a foreign operation for inclusion in the financial statements of the reporting entity, and when translating the financial statements of an entity into a different presentation currency.

- to include in IAS 21 most of the disclosures required by SIC-30, Reporting Currency – Translation from Measurement Currency to Presentation Currency, when a different translation method from that described in the previous two paragraphs is used or other supplementary information (such as an extract from the full financial statements) is displayed in a currency other than the functional currency or the presentation currency.

- to withdraw SIC-11, Foreign Exchange – Capitalisation of Losses Resulting from Severe Currency Devaluations. This is a consequence of the proposal noted above to remove the allowed alternative treatment in IAS 21, paragraph 21, which SIC-11 interprets.
- to withdraw SIC-19, Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29, and SIC-30, Reporting Currency – Translation from Measurement Currency to Presentation Currency, and incorporate their provisions (subject to the changes noted above) into the revised IAS 21.

This Exposure Draft proposes extensive editorial changes to IAS 21. Hence, for ease of reading, it is presented as a ‘clean’ draft, rather than a ‘marked-up’ version that marks the changes.

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International Accounting Standard IAS 21

(revised 200X)

The Effects of Changes in Foreign Exchange Rates

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

Objective

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.

The principal issues are which exchange rate(s) to use and how to report the effects of changes in exchange rates in the financial statements.

Scope

- 1. This Standard shall be applied:¹**
 - (a) in accounting for transactions and balances in foreign currencies, except for those derivatives transactions and balances that are within the scope of IAS 39, *Financial Instruments: Recognition and Measurement*;**
 - (b) in translating the results and financial position of foreign operations that are included in the financial statements of the**

¹ See also SIC - 7, Introduction of the Euro

entity by consolidation, proportionate consolidation or the equity method; and

(c) in translating an entity's results and financial position into a presentation currency.

2. IAS 39, Financial Instruments: Recognition and Measurement, deals with the accounting for 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 IAS 39 (eg some foreign currency derivatives that are embedded in other contracts) are within the scope of this Standard. In addition, when an entity's financial statements contain amounts for derivatives and other financial instruments, the translation of those amounts for presentation of the financial statements in a foreign currency is dealt with in this Standard.
3. This Standard does not deal with hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. Hedge accounting is dealt with in IAS 39, Financial Instruments: Recognition and Measurement.
4. This Standard deals with 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 International Financial Reporting Standards. For translations of financial information into a foreign currency that do not meet these requirements, this Standard specifies information to be disclosed.
5. This Standard does not deal with the presentation in a cash flow statement of cash flows arising from transactions in a foreign currency, or with the translation of cash flows of a foreign operation (see IAS 7, Cash Flow Statements).

Definitions

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

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

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

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

Exchange rate is the ratio of exchange for two currencies.

Spot exchange rate is the exchange rate for immediate delivery.

Closing rate is the spot exchange rate at the balance sheet date.

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

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

Net investment in a foreign operation is the amount of the reporting entity's interest in the net assets of that operation.

Monetary items are money held and assets and liabilities to be received or paid in fixed or determinable amounts of money.

Fair value is the amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.

Elaboration on the Definitions

Functional Currency

7. 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) in which sales prices for its goods and services are denominated and settled (or the currency that mainly influences sales prices, when that is different)

- (ii) of the country whose competitive forces and regulations mainly determine the sales price of its goods and services.
 - (b) the currency in which labour, material and other costs of providing goods or services are denominated and settled (or the currency that mainly influences such costs, when that is different).
8. The following factors may also provide evidence of an entity's functional currency:
- (a) the currency in which funds from financing activities (ie issuing debt and equity instruments) are generated.
 - (b) the currency in which receipts from operating activities are usually retained.
9. When the entity is a foreign operation, the following additional factors are considered in determining the entity's functional currency, and in particular whether its functional currency is the same as that of the reporting entity (the reporting entity being the entity that has the foreign operation as its subsidiary, branch, associate or joint venture):
- (a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.
 - (b) whether transactions with the reporting entity are a high or 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.

10. In cases when the above indicators are mixed and the functional currency is not obvious, management uses its judgement to determine the functional currency that most faithfully represents the economic effects of the underlying transactions, events and circumstances.
11. An entity's functional currency reflects the underlying transactions, events and circumstances 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 circumstances.
12. If the functional currency is the currency of a hyperinflationary economy, the entity's financial statements are restated under IAS 29, Financial Reporting in Hyperinflationary Economies. An entity cannot avoid restatement under IAS 29 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 parent).

Net Investment in a Foreign Operation

13. 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 30 and 31. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

Monetary Items

14. The essential feature of a monetary item is a right to receive (or an obligation to deliver) a fixed or determinable amount of money. Examples include: deferred tax; pensions and other employee benefits to be paid in cash; provisions that are to be settled in cash; and cash dividends that are recognised 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 amount of money. Examples include: amounts prepaid for goods and services (eg 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.

Summary of the Approach Required by this Standard

15. In preparing financial statements, the functional currency of each individual entity—whether a stand-alone entity, an entity with foreign operations (such as a parent) or a foreign operation (such as a subsidiary or branch)—is determined in accordance with paragraphs 6-12. The entity translates foreign currency items into its functional currency and reports the effects of such translation in accordance with paragraphs 18-35 and 48.
16. Many reporting entities are groups that comprise a number of individual entities (eg subsidiaries, associates, joint ventures, branches and the parent entity) with different functional currencies. It is necessary for the results and financial position of each individual entity within the group to be translated into the currency in which the group financial statements are to be presented. This Standard permits the presentation currency of a group to be any currency (or currencies). The results and financial position of any individual entity within the group whose functional currency differs from the chosen presentation currency are translated in accordance with paragraphs 36-48.
17. This Standard also permits the financial statements of a stand-alone reporting entity to be presented in any currency (or currencies). If the presentation currency differs from the entity's functional currency, its results and financial position are also translated into the presentation currency in accordance with paragraphs 36-48.

Reporting Foreign Currency Transactions in the Functional Currency

Initial Recognition

18. 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.
- 19. *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.***
20. The date of a transaction is the date on which the transaction first qualifies for recognition under International Financial Reporting Standards. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly the use of the average rate for a period is inappropriate.

Reporting at Subsequent Balance Sheet Dates

21. *At each balance sheet 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 value was determined.*
22. The carrying amount of an item is determined in conjunction with other relevant Standards. For example, property, plant and equipment may be measured in terms of fair value or historical cost in accordance with IAS 16, 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.

23. The carrying amount of some items is determined by comparing two or more amounts. For example, the carrying amount of inventories is determined as the lower of cost and net realisable value in accordance with IAS 2, Inventories, and the carrying amount of an asset for which there is an indication of impairment is determined as the lower of its previous carrying amount and recoverable amount in accordance with IAS 36, Impairment of Assets. 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 that amount was determined (ie the rate at the date of the transaction for an item measured in terms of historical cost), and
 - (b) the net realisable value or recoverable amount, as appropriate, translated at the exchange rate at the date that value was determined (ie the closing rate when the value was determined at the balance sheet date).

The effect of this comparison may be that a write-down is required in the functional currency that would not be required in the foreign currency, or vice versa.

24. When several exchange rates are available, the rate to be 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 first subsequent rate at which exchanges could be made is used.

Recognition of Exchange Differences

25. As noted in paragraph 3, IAS 39, Financial Instruments: Recognition and Measurement, deals with hedge accounting for foreign currency items. The application of IAS 39 may require some exchange differences to be accounted for differently from the manner set out in this Standard. For example, IAS 39 requires that exchange differences on monetary items that qualify as a hedging instrument in a cash flow

hedge are reported initially in equity to the extent the hedge is effective.

26. ***Exchange differences arising on the settlement of monetary items or on translating an entity's monetary items at rates different from those at which they were initially translated during the period, or translated in previous financial statements, shall be recognised as income or expenses in the period in which they arise, with the exception of exchange differences dealt with in accordance with paragraph 30.***
27. An exchange difference results when there is a change in the exchange rate between the transaction date and the date of settlement of monetary items arising from a foreign currency transaction. When the transaction is settled within the same accounting period as that in which it occurred, all the exchange difference is recognised in that period. However, when the transaction is settled in a subsequent accounting period, the exchange difference recognised in each intervening period up to the period of settlement is determined by the change in exchange rates during that period.
28. ***When a gain or loss on a non-monetary item is recognised directly in equity, any exchange component of that gain or loss shall be recognised directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, any exchange component of that gain or loss shall be recognised in profit or loss.***
29. Other Standards require some gains and losses to be recognised directly in equity. For example, IAS 16, Property, Plant and Equipment, requires some gains and losses arising on a revaluation of property, plant and equipment to be recognised directly in equity. When such an asset is measured in a foreign currency, paragraph 21(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 recognised in equity.
30. ***Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation (see paragraph 13) shall be recognised as income or expense in the separate financial statements of the reporting entity or the foreign operation. In the financial statements that include the foreign operation and the reporting entity (ie consolidated financial statements where the foreign operation is a subsidiary), such***

exchange differences shall be recognised initially in a separate component of equity and recognised as income or expenses on disposal of the net investment in accordance with paragraph 46.

31. When a monetary item that forms part of a reporting entity's net investment in a foreign operation is denominated in the functional currency of the reporting entity, an exchange difference arises in the foreign operation's separate financial statements in accordance with paragraph 26. Similarly, 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 26. Such exchange differences are reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity (ie financial statements in which the foreign operation is consolidated, proportionately consolidated or accounted for using the equity method). In addition, a monetary item that forms part of the reporting entity's net investment in a foreign operation may be denominated in a currency other than the functional currency of either the reporting entity or the foreign operation. The exchange differences that arise on translating the monetary item into the functional currencies of the reporting entity and the foreign operation are not reclassified to the separate component of equity in the financial statements that include the foreign operation and the reporting entity.
32. When an entity keeps its books and records in a currency other than its functional currency, all amounts are remeasured in the functional currency in accordance with paragraphs 18-24. 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 carried in terms of historical cost are remeasured using the exchange rate at the date of the transaction that resulted in recognition of the item.

Change in the Functional Currency of an Entity

33. *When there is a change in the functional currency of an entity, the translation procedures applicable to the new functional currency shall be applied from the date of the change.*

34. As noted in paragraph 11, the functional currency of an entity reflects the underlying transactions, events and circumstances that are relevant to the entity. Accordingly, once the functional currency is determined, it is changed only if there is a change to those underlying transactions, events and circumstances. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.
35. The effect of a change in functional currency is accounted for prospectively. All items are translated 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 on the translation of a foreign operation previously classified in equity in accordance with paragraphs 30 and 37(c) are not recognised as income or expenses until the disposal of the operation.

Use of a Presentation Currency other than the Functional Currency

Translation to the Presentation Currency

36. Under this Standard, the financial statements of an entity may be presented in any currency (or currencies). If the presentation currency differs from the entity's functional currency, its results and financial position need to be translated into the presentation currency. In particular, when a group contains individual entities with different functional currencies, the results and financial position of each entity need to be expressed in a common currency so that group financial statements may be presented.
37. *The results 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, liabilities and equity items other than those resulting from income and expenses recognised in the period, for each balance sheet presented (ie including comparatives) shall be translated at the closing rate at the date of that balance sheet;*

- (b) income and expenses recognised in the period, for each period presented (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and*
- (c) all resulting exchange differences shall be recognised as a separate component of equity.*

38. For practical reasons, a rate that approximates the actual exchange rates at the dates of the transactions, for example an average rate for the period, is often used to translate income and expense items. However, if exchange rates fluctuate significantly the use of the average rate for a period is inappropriate.
39. The exchange differences referred to in paragraph 37(c) result from:
- (a) translating income and expenses recognised in the period at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences arise both on income and expense items recognised in profit or loss and on those that other Standards require to be recognised directly in equity; and
 - (b) in the case of a net investment in a foreign operation, translating the opening net assets at an exchange rate different from that at which they were previously reported.

These exchange differences are not recognised as income or expenses for the period 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 not wholly-owned, accumulated exchange differences arising from translation and attributable to minority interests are allocated to, and recognised as part of, the minority interest in the consolidated balance sheet.

40. *The results 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 (ie assets, liabilities, equity items, income items and expense items, including comparatives) shall be translated at the closing rate at the date of the most recent balance sheet, except that*

- (b) when amounts are being 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 (ie not adjusted for either subsequent changes in the price level or subsequent changes in exchange rates).*
- 41. When the functional currency of an entity is the currency of a hyperinflationary economy, its financial statements shall be restated under IAS 29, Reporting in Hyperinflationary Economies, before the translation method set out in paragraph 40 is applied, except for comparative amounts that are being translated into a currency of a non-hyperinflationary economy (see paragraph 40(b)). When the economy ceases to be hyperinflationary and the entity no longer restates its financial statements in accordance with IAS 29, it shall use the amounts restated to the price level at the date the entity ceased restating its financial statements as the historical costs for translation into the presentation currency.**

Translation of a Foreign Operation

- 42.** Paragraphs 43-45 apply when the results and financial position of a foreign operation are translated into a presentation currency so that the foreign operation can be included in the financial statements of the reporting entity by consolidation, proportionate consolidation or the equity method.
- 43.** The incorporation of the results and financial position of a foreign operation with those of the reporting entity follows normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see IAS 27, Consolidated and Separate Financial Statements, and IAS 31, Financial Reporting of Interests in Joint Ventures). However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting entity, such an exchange difference continues to be

recognised as income or expense or, if it arises from the circumstances described in paragraph 30, it is classified as equity until the disposal of the foreign operation.

44. When the financial statements of a foreign operation are drawn up to a different reporting date from those of the reporting entity, the foreign operation often prepares additional statements as at the same date as the reporting entity's financial statements. When this is not done, IAS 27, Consolidated and Separate Financial Statements, allows the use of a different reporting date provided that the difference is no greater than three months and adjustments are made for the effects of any significant transactions or other events that occur between the different reporting dates. In such a case, the assets and liabilities of the foreign operation are translated at the exchange rate at the balance sheet date of the foreign operation. Adjustments are made for significant movements in exchange rates up to the balance sheet date of the reporting entity in accordance with IAS 27. The same approach is used in applying the equity method to associates and joint ventures and in applying proportionate consolidation to joint ventures in accordance with IAS 28, Accounting for Investments in Associates, and IAS 31, Financial Reporting of Interests in Joint Ventures.
45. *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 and shall be translated at the closing rate in accordance with paragraphs 37 and 40.*

Disposal of a Foreign Operation

46. *On the disposal of a foreign operation, the cumulative amount of the exchange differences that have been deferred in the separate component of equity and that relate to that foreign operation shall be recognised as income or expenses in the same period in which the gain or loss on disposal is recognised.*
47. An entity may dispose of its interest in a foreign operation through sale, liquidation, repayment of share capital, or abandonment of all, or part of, that entity. The payment of a dividend is part of a disposal only when it constitutes a return of the investment, for example when the

dividend is paid out of pre-acquisition profits. In the case of a partial disposal, only the proportionate share of the related accumulated exchange differences is included in the gain or loss. A write-down of the carrying amount of a foreign operation does not constitute a partial disposal. Accordingly, no part of the deferred foreign exchange gain or loss is recognised as income or expense at the time of a write-down.

Tax Effects of All Exchange Differences

48. Gains and losses on foreign currency transactions and exchange differences arising on translating the results and financial position of an entity (including a foreign operation) into a different currency may have associated tax effects, which are accounted for in accordance with IAS 12, Accounting for Taxes on Income.

Disclosure

49. *In paragraphs 50, 51 and 53-55 below references to 'functional currency' shall, in the case of a group, be taken to refer to the functional currency of the parent.*
50. *An entity shall disclose:*
- (a) the amount of exchange differences included in profit or loss for the period; and*
 - (b) net exchange differences classified in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.*
51. *When the presentation currency is different from the functional currency, this fact shall be stated, together with disclosure of the functional currency and the reason for using a different presentation currency.*
52. *When there is a change in the functional currency of either the reporting entity or a significant foreign operation, that fact shall be disclosed.*
53. *When an entity presents its financial statements in a currency that is different from its functional currency, it shall describe the financial statements as complying with International Financial Reporting*

Standards only if they comply with all the requirements of each applicable Standard and each applicable Interpretation of those Standards including the translation method set out in paragraphs 37 and 40.

54. An entity sometimes presents its financial statements or other financial information in a currency that is different from its functional currency without meeting the requirements of paragraph 53. For example, an entity may convert only selected items from its financial statements into another currency. Or an entity whose functional currency is not the currency of a hyperinflationary economy may convert the financial statements into another currency by translating all items at the most recent closing rate. Such conversions are not in accordance with International Financial Reporting Standards and the disclosures set out in paragraph 55 are required.
55. ***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 53 are not met, it shall:***
- (a) ***clearly identify the information as supplementary information to distinguish it from the information that complies with International Financial Reporting Standards;***
 - (b) ***disclose the currency in which the supplementary information is displayed; and***
 - (c) ***disclose the entity's functional currency and the method of translation used to determine the supplementary information.***

Effective Date

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

Appendix

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 21. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to the accounting for the effects of changes in foreign exchange rates established by IAS 21, this Basis for Conclusions does not discuss requirements in IAS 21 that the Board has not reconsidered.

Functional currency

- A3. Paragraph 7 of IAS 21 defines the term 'reporting currency' as 'the currency used in presenting the financial statements'. This definition comprises two separate notions (which are identified separately in SIC-19, Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29): the measurement currency (the currency in which the entity measures the items in the financial statements); and the presentation currency (the currency in which the entity presents its financial statements). The Board decided to revise IAS 21 to incorporate the SIC-19 approach of separating these two notions. The Board also noted that the term 'functional currency' is more commonly used than 'measurement currency' and decided to adopt the more common term.
- A4. The Board noted a concern that the guidance in SIC-19 on determining a measurement currency can permit entities to choose one of several currencies, or to select the 'wrong' currency. In particular, some believe that SIC-19 places too much emphasis on the currency in which transactions are denominated and too little emphasis on the

underlying economy that determines the pricing of those transactions. To meet these concerns, the Board proposes to define functional currency as ‘the currency of the primary economic environment in which the entity operates’. The Board also proposes to provide guidance on how to determine the functional currency (see paragraphs 7-12). This guidance draws heavily on SIC-19 and equivalent guidance in US and other national standards, but also reflects the Board’s decision that some factors merit greater emphasis than others.

- A5. Lastly on functional currency, the Board discussed whether an integral foreign operation (as described in paragraphs 23-26 of IAS 21) could have a functional currency that is different from that of its ‘parent’.² The Board decided that the functional currencies will always be the same, because it would be contradictory for an integral foreign operation that ‘carries on business as if it were an extension of the reporting enterprise’s operations’³ to operate in a different primary economic environment from the parent’s.
- A6. It follows that there will be no need to translate the results and financial position of an integral foreign operation so that they can be incorporated into the financial statements of the parent—they will already be measured in the parent’s functional currency. Furthermore, it is not necessary to distinguish between an integral foreign operation and a foreign entity. When a foreign operation has a functional currency that is different from that of its parent, it must be a foreign entity, and the translation method in IAS 21, paragraph 30 will apply.
- A7. The Board also decided that the principles at present in IAS 21 for distinguishing an integral foreign operation from a foreign entity are relevant to determining an operation’s functional currency. Hence it proposes incorporating these principles into the revised IAS 21 in that context.

² The term ‘parent’ is used broadly in this context to mean an entity that has a branch, associate or joint venture, as well as one with a subsidiary.

³ IAS 21, paragraph 24

Presentation currency

- A8. A further issue is whether an entity should be permitted to present its financial statements in a currency (or currencies) other than its functional currency. Some believe it should not. They believe that the functional currency, being the currency of the primary economic environment in which the entity operates, most usefully portrays the economic effect of transactions and events on the entity. For a group that comprises operations with a number of functional currencies, they believe that the financial statements should be presented in the functional currency that management uses when controlling and monitoring the performance and financial position of the group. They also believe that allowing an entity to present its financial statements in more than one currency may confuse, rather than help, users of those financial statements. Supporters of this view believe that any presentation in a currency other than that described above should be regarded as a 'convenience translation' that is outside of the scope of IFRSs.
- A9. Others are of the view that a limited choice of presentation currency should be permitted, for example by limiting the presentation currency to the functional currency of any of the substantive entities within a group. However, such a restriction might be easily overcome—an entity that wished to present its financial statements in a different currency might establish a relatively small operation with that functional currency.
- A10. Still others believe that, given the rising trend towards globalisation, entities should be permitted to present their financial statements in any currency. They note that most large groups do not have a single functional currency, but rather comprise operations with a number of functional currencies. For such entities, they believe it is not clear which currency should be the presentation currency, or why one currency is preferable to another. They also point out that management may not use a single currency when controlling and monitoring the performance and financial position of such a group. In addition, they note that in some jurisdictions, entities are required to present their financial statements in the local currency, even when this

is not the functional currency.⁴ Hence, if IFRSs were to require the financial statements to be presented in the functional currency, some entities would have to present two sets of financial statements: financial statements that comply with IFRSs presented in the functional currency and financial statements that comply with local regulations presented in a different currency.

- A11. The Board was persuaded by the arguments in the previous paragraph. Accordingly, it proposes that entities be permitted to present their financial statements in any currency (or currencies) that they choose.

Translation method

- A12. The Board debated the method to be used to translate financial statements from an entity's functional currency into a different presentation currency.

- A13. The Board agreed that the translation method should *not* have the effect of substituting another currency for the functional currency. Put another way, presenting the financial statements in a different currency should not change the way in which the underlying items are measured. Rather, the translation method should merely *express* the underlying amounts, as measured in the functional currency, in a different currency.

- A14. Given this, the Board considered two possible translation methods. The first is to translate all amounts (including comparatives) at the most recent closing rate. This method has several advantages: it is simple to apply; it does not generate any new gains and losses; and it does not change ratios such as return on assets. This method is supported by those who believe that the process of merely *expressing* amounts in a different currency should preserve the relationships among amounts as measured in the functional currency and, as such, should not lead to any new gains or losses.

- A15. The second method considered by the Board is the one that IAS 21, paragraph 30 requires for translating the financial statements of a

⁴ This includes entities operating in another country and, for example, publishing financial statements to comply with a listing requirement of that jurisdiction.

foreign operation.⁵ This method results in the same amounts in the presentation currency regardless of whether the financial statements of a foreign operation are:

- (a) first translated into the functional currency of another group entity (eg the parent) and then into the presentation currency, or
- (b) translated directly into the presentation currency.

A16. Hence this method avoids the need to decide the currency in which to express the financial statements of a multinational group before they are translated into the presentation currency. As noted above, many large groups do not have a single functional currency, but comprise operations with a number of functional currencies. For such entities it is not clear which functional currency should be chosen to express amounts in before they are translated into the presentation currency, or why one currency is preferable to another. In addition, this method produces the same amounts in the presentation currency for a stand-alone entity as for an identical subsidiary of a parent whose functional currency is the presentation currency.

A17. The Board decided to propose the second method, ie that the financial statements of any entity (whether a stand-alone entity, a parent or an operation within a group) whose functional currency differs from the presentation currency used by the reporting entity are translated using the method set out in IAS 21, paragraph 30.

A18. The Board decided to incorporate into IAS 21 most of the disclosure requirements of SIC-30, Reporting Currency – Translation from Measurement Currency to Presentation Currency, that apply when a different translation method is used or other supplementary information, such as an extract from the full financial statements, is displayed in a currency other than the functional currency (see paragraph 55). These disclosures enable users to distinguish information prepared in accordance with IFRSs from information that may be useful to users but is not the subject of Standards, and also tell users how the latter information has been prepared.

⁵ This is to translate balance sheet items at the closing rate and income and expense items at actual (or average) rates, except for an entity whose functional currency is that of a hyperinflationary economy.

Capitalisation of exchange differences

- A19. Paragraphs 15 and 21 of IAS 21 allow a choice of accounting for exchange differences that “arise from a severe devaluation or depreciation of a currency against which there is no practical means of hedging and that affects liabilities which cannot be settled and which arise directly on the recent acquisition of an asset”. The benchmark treatment is to recognise such exchange differences in profit or loss. The allowed alternative is to capitalise them.
- A20. The Board noted that the allowed alternative (of capitalisation) is not in accordance with the Framework for the Preparation and Presentation of Financial Statements, because exchange losses do not meet the definition of an asset. Moreover, capitalisation is neither allowed nor required by any liaison standard-setter, so its deletion would improve convergence. Finally, in many cases when the conditions for capitalisation are met, the asset would be restated in accordance with IAS 29, Financial Reporting in Hyperinflationary Economies. Thus, to the extent that an exchange loss reflects hyperinflation, this effect is taken into account under IAS 29. For all of these reasons, the Board decided to propose removing the allowed alternative treatment and withdrawing the related SIC Interpretation.

Goodwill and fair value adjustments

- A21. Paragraph 33 of IAS 21 allows a choice of whether to translate goodwill and fair value adjustments to assets and liabilities that arise on the acquisition of a foreign entity at (a) the closing rate or (b) the historical transaction rate.
- A22. The Board agreed that, conceptually, the correct treatment depends on whether goodwill and fair value adjustments are part of:
- (a) the assets and liabilities of the acquired entity (which would imply translating them at the closing rate); or
 - (b) the assets and liabilities of the parent (which would imply translating them at the historical rate).
- A23. The Board agreed that fair value adjustments are clearly part of the cost of acquiring the identifiable assets and liabilities of the acquired entity and should therefore be translated at the closing rate.

- A24. Goodwill is more complex, partly because it is a residual. In addition, the Board noted that difficult issues can arise when the acquired entity contains businesses that have different functional currencies (eg if the acquired entity is a multinational group). The Board discussed how to assess any resulting goodwill for impairment under the approach being developed in the Business Combinations project and, in particular, whether the goodwill would need to be 'pushed down' to the level of each different functional currency or could be accounted for and assessed at a higher level.
- A25. One view is that when the parent acquires a multinational operation comprising businesses with many different functional currencies, any goodwill may be treated as an asset of the parent/acquirer and tested for impairment at a consolidated level. Those who support this view believe that, in economic terms, the goodwill is an asset of the parent because it is part of the acquisition price paid by the parent. Thus, they believe that it would be incorrect to allocate the goodwill to the many acquired businesses and translate it into their various functional currencies. Rather, the goodwill, being treated as an asset of the parent, is not exposed to foreign currency risks, and translation differences should not be reported on it. In addition, they believe that such goodwill may be tested for impairment at a consolidated level. Under this view, allocating or 'pushing down' the goodwill to a lower level, such as each different functional currency within the acquired foreign operation, would not serve any purpose.
- A26. Others take a different view. They believe that the goodwill is part of the parent's net investment in the acquired entity. In their view, goodwill should be treated no differently from other assets of the acquired entity, in particular intangible assets, since a significant part of the goodwill is likely to comprise intangible assets that do not qualify for separate recognition. They also note that goodwill arises only because of the investment in the foreign entity and has no existence apart from that entity. Lastly, they point out that when the acquired entity comprises a number of businesses with different functional currencies, the cash flows that support the continued recognition of goodwill are generated in those various different functional currencies.
- A27. The majority of the Board was persuaded by the reasons set out in paragraph A26. Accordingly, paragraph 45 of the Exposure Draft proposes that goodwill is treated as an asset of the foreign operation and translated at the closing rate. However, two Board members

support the view that is set out in paragraph A25: they would treat goodwill arising on an acquisition made by the parent as an asset of the parent and translate it at the historical rate. Nevertheless, their disagreement with the majority view on this matter did not lead these two Board members to dissent from the publication of the Exposure Draft. The Board also decided that the level within the acquired entity to which goodwill should be 'pushed down' when the acquired entity contains businesses with different functional currencies should be kept under review in the context of the proposals for impairment testing of goodwill being developed in the Business Combinations project.

**Proposed Improvements to
International Accounting Standard IAS 24
(reformatted 1994)**

Related Party Disclosures

International Accounting Standard IAS 24

(revised 200X)

Related Party Disclosures

Invitation to Comment

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

Question 1

Do you agree that the Standard should not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations (see paragraph 2)?

'Management' and 'compensation' would need to be defined, and measurement requirements for management compensation would need to be developed, if disclosure of these items were to be required. If commentators disagree with the Board's proposal, the Board would welcome suggestions on how to define 'management' and 'compensation'.

Question 2

Do you agree that the Standard should not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs (see paragraph 3)?

(Note that this proposal is the subject of alternative views of Board members, as set out in Appendix B.)

Summary of Main Changes

The main changes proposed are:

- to add proposed paragraph 2, which states that the Standard does not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations.
- to incorporate the examples of related parties in paragraph 3 of IAS 24 into the definition of 'related party' in proposed paragraph 9.
- to remove paragraph 4(d), which exempted financial statements of state-controlled enterprises from disclosing transactions with other state-controlled enterprises.
- to make the following changes to the definitions in proposed paragraph 9:
 - to add the following parties to the definition of 'related party':
 - parties with joint control over the entity;
 - joint ventures in which the entity is a venturer; and
 - post-employment benefit plans for the benefit of employees of the entity, or of any entity that is a related party of the entity.
 - to clarify in the definition of 'related party' that non-executive directors are key management personnel.
 - to add a definition of 'close members of the family of an individual'.
- to add proposed paragraph 11(b) to indicate that two venturers are not related parties simply because they share joint control over a joint venture.
- to remove paragraphs 11-16 of IAS 24, which discuss the methods used to price transactions between related parties. The Standard does not require remeasurement of related party transactions.
- to add to paragraph 19 of IAS 24 the following example of transactions that are disclosed if they are with a related party:

- settlement of liabilities on behalf of the entity or by the entity on behalf of another party (see proposed paragraph 16).
- to amend paragraphs 22 and 23 of IAS 24 so that it no longer is sufficient to disclose proportions of transactions and outstanding balances in respect of related parties – instead, the amounts must be disclosed (see proposed paragraph 14).
- to add to paragraphs 22 and 23 of IAS 24 the following disclosures about outstanding balances with related parties:
 - their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement;
 - details of any guarantees given or received; and
 - provisions for doubtful debts (see proposed paragraph 14).
- to add to paragraphs 22 and 23 of IAS 24 a requirement to disclose the expense recognised during the period in respect of bad or doubtful debts due from related parties (see proposed paragraph 14).
- to add proposed paragraph 15, which is a requirement transferred from paragraph 72 of IAS 1, Presentation of Financial Statements, to subclassify amounts payable to, and receivable from, different categories of related parties. The categories to be disclosed would be extended to provide a more comprehensive analysis of these related party balances and would also apply to related party transactions.
- to add proposed paragraph 17, which states that disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such disclosures can be substantiated.
- to remove paragraph 23(c) of IAS 24, which indicated that disclosure normally would be made of pricing policies in respect of related party transactions.

This Exposure Draft proposes extensive changes to IAS 24. Hence, for ease of reading, it is presented as a 'clean' draft rather than a 'marked-up' version that marks the changes.

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International Accounting Standard IAS 24 (revised 200X)

Related Party Disclosures

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

Objective

The objective of this Standard is to prescribe the disclosure of information about related party relationships and about transactions and outstanding balances between an entity and its related parties.

Scope

1. ***This Standard shall be applied in:***
 - (a) ***identifying related party relationships, and transactions and outstanding balances between an entity and its related parties;***
 - (b) ***identifying the circumstances in which disclosure of the items in (a) is required in general purpose financial statements; and***
 - (c) ***determining the disclosures to be made about those items.***
2. ***This Standard does not require disclosure of management compensation, expense allowances and similar items paid in the ordinary course of an entity's operations.***
3. ***This Standard does not require disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a wholly-owned subsidiary that are made available or published with consolidated financial statements for the group to which that entity belongs.***

4. Related party transactions and outstanding balances with other entities in a group are disclosed in an entity's separate financial statements unless such disclosures are exempted under paragraph 3. Intra-group related party transactions and outstanding balances are eliminated in the preparation of consolidated financial statements of the group.

Purpose of Related Party Disclosures

5. Related party relationships are a normal feature of commerce and business. For example, entities frequently carry on parts of their activities through subsidiary or associated entities and acquire interests in other entities for investment purposes or for trading reasons that are of sufficient proportions that the investor can control or jointly control its investee, or can exercise significant influence over the financial and operating decisions of its investee.
6. A related party relationship could have an effect on the profit or loss, financial position and cash flows of an entity. Related parties may enter into transactions that unrelated parties would not enter into. For example, an entity that sells goods to its parent at cost might not sell on those terms to another customer. Also, transactions between related parties may not be made at the same amounts as between unrelated parties.
7. The profit or loss, financial position and cash flows of an entity may be affected by a related party relationship even if related party transactions do not occur. The mere existence of the relationship may be sufficient to affect the transactions of the entity with other parties. For example, a subsidiary may terminate relations with a trading partner on acquisition by the parent of a fellow subsidiary engaged in the same activity as the former trading partner. Alternatively, one party may refrain from acting because of the significant influence of another—for example, a subsidiary may be instructed by its parent not to engage in research and development.
8. For these reasons, knowledge of related party transactions, outstanding balances and relationships may affect assessments of an entity's operations by users of financial statements, including assessments of the risks and opportunities facing the entity.

Definitions

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

Related party *A party is related to an entity if:*

- (a) *directly, or indirectly through one or more intermediaries, it:*
 - (i) *controls, or is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);*
 - (ii) *has an interest in the entity that gives it significant influence over the entity; or*
 - (iii) *has joint control over the entity;*
- (b) *it is an associate (as defined in IAS 28, Accounting for Investments in Associates) of the entity;*
- (c) *it is a joint venture in which the entity is a venturer (see IAS 31, Financial Reporting of Interests in Joint Ventures);*
- (d) *it is a member of the key management personnel of the entity or its parent, that is, those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) or officer of that entity;*
- (e) *it is a close member of the family of any individual referred to in subparagraph (a) or (d);*
- (f) *it is an entity in which a controlling or jointly controlling interest in, or significant influence over, the voting power is owned, directly or indirectly, by any individual referred to in (d) or (e); or*
- (g) *it is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.*

A related party transaction *is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged.*

Control is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

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

Significant influence is the power to participate in the financial and operating policy decisions of an entity, but is not control over those policies. Significant influence may be gained by share ownership, statute or agreement.

Close members of the family of an individual are those family members who may be expected to influence, or be influenced by, that individual in their dealings with the entity. They include:

- (a) the individual's domestic partner and children;***
- (b) children of the individual's domestic partner; and***
- (c) dependants of the individual or the individual's domestic partner.***

10. In considering each possible related party relationship, attention is directed to the substance of the relationship and not merely the legal form.
11. In the context of this Standard, the following are not related parties:
 - (a) two entities simply because they have a director or other member of key management personnel in common, notwithstanding subparagraphs (d) and (f) in the definition of 'related party';
 - (b) two venturers simply because they share joint control over a joint venture;
 - (c)
 - (i) providers of finance;
 - (ii) trade unions;
 - (iii) public utilities; and
 - (iv) government departments and agencies,by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision-making process); and

- (d) a customer, supplier, franchisor, distributor, or general agent with whom an entity transacts a significant volume of business merely by virtue of the resulting economic dependence.

Disclosure

- 12. *Relationships between parents and subsidiaries shall be disclosed irrespective of whether there have been transactions between those related parties.*
- 13. To enable users of financial statements to form a view about the effects of related party relationships on an entity, it is appropriate to disclose the related party relationship where control exists, irrespective of whether there have been transactions between the related parties.
- 14. *If there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. At a minimum, disclosures shall include:*
 - (a) *the amount of the transactions;*
 - (b) *the amount of outstanding balances and:*
 - (i) *their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and*
 - (ii) *details of any guarantees given or received;*
 - (c) *provisions for doubtful debts related to the amount of outstanding balances; and*
 - (d) *the expense recognised during the period in respect of bad or doubtful debts due from related parties.*
- 15. *The disclosures in paragraph 14 shall be made separately for each of the following categories:*
 - (a) *the parent;*
 - (b) *entities with joint control or significant influence over the entity;*

- (c) *subsidiaries;*
 - (d) *associates;*
 - (e) *joint ventures in which the entity is a venturer;*
 - (f) *key management personnel of the entity or its parent; and*
 - (g) *other related parties.*
16. The following are examples of transactions that are disclosed if they are with a related party:
- purchases or sales of goods (finished or unfinished);
 - purchases or sales of property and other assets;
 - rendering or receiving of services;
 - leases;
 - transfers of research and development;
 - transfers under licence agreements;
 - transfers under finance arrangements (including loans and equity contributions in cash or in kind);
 - provision of guarantees or collateral; and
 - settlement of liabilities on behalf of the entity or by the entity on behalf of another party.
17. Disclosures that related party transactions were made on terms equivalent to those that prevail in arm's length transactions are made only if such disclosures can be substantiated.
18. ***Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.***
19. Transactions with associates accounted for under the equity method and joint ventures accounted for under either proportionate consolidation or the equity method are not fully eliminated in preparing financial statements. Therefore, they are disclosed as related party transactions unless the exemption in paragraph 3 is used.

Effective Date

20. *This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged.*

Appendix A

Basis for Conclusions (Revisions 200X)

- A1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- A2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of Standards, including IAS 24. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental approach to the disclosure of related party transactions and outstanding balances established by IAS 24, this Basis for Conclusions does not discuss requirements in IAS 24 that the Board has not reconsidered.

Management compensation

- A3. The Board proposes that disclosure of management compensation, expense allowances and similar items paid in the ordinary course of business should not be required because:
- (a) in some jurisdictions, the processes for approving management compensation remove the rationale for related party disclosures. These processes avoid the potential for the related party relationship between key management personnel and an entity to affect the amount of management compensation paid in the ordinary course of business;
 - (b) requiring disclosure of management compensation gives rise to privacy issues that, in some jurisdictions, are responded to by accountability mechanisms other than disclosure in financial statements; and
 - (c) to require these disclosures, IAS 24 would need to define 'management' and 'compensation', which is likely to prove

contentious. In addition, comparability of these disclosures would be unlikely until measurement requirements are developed for all forms of management compensation.

- A4. The Board noted that corresponding standards of some national standard setters do not require disclosure of these items. The Board noted concerns that IAS 24 should not exempt these items from disclosure because, in other jurisdictions, disclosure in financial statements is the primary accountability mechanism for management compensation. The Board concluded that, in view of the points in paragraph A3, it is preferable for national standard setters in these other jurisdictions to require disclosure of management compensation than for IAS 24 to require these disclosures in financial statements prepared under International Financial Reporting Standards in any jurisdiction. The Board also noted that dealing with the fundamental issues mentioned in paragraph A3(c) is beyond the scope of its Improvements project.

Exemption from related party disclosures in separate financial statements of a parent or wholly-owned subsidiary

- A5. Paragraph 4 of IAS 24 states that:

‘No disclosure of transactions is required: ...

- (b) in parent financial statements when they are made available or published with the consolidated financial statements; and
- (c) in financial statements of a wholly-owned subsidiary if its parent is incorporated in the same country and provides consolidated financial statements in that country; .’.

- A6. The Board proposes to continue exempting separate financial statements of parents and wholly-owned subsidiaries from disclosures about any related parties in certain circumstances. Paragraph 3 of the Exposure Draft states that ‘disclosure of related party transactions and outstanding balances in the separate financial statements of a parent or a wholly-owned subsidiary’ is not required, but only if those statements ‘are made available or published with consolidated financial statements for the group .’.

- A7. The Board decided to retain an exemption from related party disclosures so that entities that are required by law to publish financial statements under International Financial Reporting Standards in addition to the group's consolidated financial statements would not be unduly burdened. The Board noted that in some circumstances, users can obtain sufficient information for making economic decisions about a parent from either its separate financial statements or the group's consolidated financial statements. The Board also noted that users should be aware that the amounts recognised in the financial statements of a wholly-owned subsidiary can be affected significantly by the subsidiary's relationship with its parent.

Appendix B

Alternative Views

- B1. Alternative views represent the views of Board members who voted against the publication of this Exposure Draft. Those Board members have concluded that the proposed revised text for IAS 24, Related Party Disclosures, taken as a whole, should not be published in its present form.
- B2. Board members' views (including the views of Board members who supported publication of this Exposure Draft) may change as a result of input received in the exposure process.
- B3. The IASB does not allow partial dissents. The Basis for Conclusions presents several views considered by the Board, including some supported by a minority of Board members who, nonetheless, support publication of the Exposure Draft for this Standard.

Exemption from related party disclosures in separate financial statements of a parent or wholly-owned subsidiary

- B4. Six Board members disagree with paragraph 3 of the Exposure Draft. These members note that the financial statements of an entity that is part of a consolidated group, including those of the parent or a wholly-owned subsidiary, may include the effects of extensive intra-group transactions. Indeed, potentially all of the revenues and expenses for such an entity may derive from related party transactions. These Board members believe that the disclosures required by IAS 24 are essential to understanding the financial position and financial performance of such an entity and therefore should be required for financial statements purported to be in compliance with International Financial Reporting Standards.
- B5. These members accept that International Financial Reporting Standards must accommodate the presentation of separate financial statements for a parent or wholly-owned subsidiary that reflect the perspective of the parent or wholly-owned subsidiary as an investor, rather than as part of the consolidated entity. However, these

members believe that this alternative perspective does not reduce the need for related party disclosures; indeed, it may increase that need.

- B6. These members also note that material transactions between a parent or wholly-owned subsidiary and related parties outside the group might be immaterial to the group. In these cases, when the exemption in paragraph 3 is used, these related party transactions would be disclosed neither in the entity's separate financial statements nor in the consolidated financial statements for the group.

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

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

**Inventories International Accounting
Standard IAS 27
(revised 200X)**

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

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

Invitation to Comment

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

Question 1

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

Question 2

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

Question 3

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

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

Summary of Main Changes

The main changes proposed are:

- to modify the exemption from preparing consolidated financial statements (paragraph 8) to indicate that a parent need not present consolidated financial statements to comply with International Financial Reporting Standards if and only if:
 - (a) it is a wholly-owned subsidiary or the owners of the minority interests, including those not otherwise entitled to vote, unanimously agree that the parent need not present consolidated financial statements;
 - (b) its securities are not publicly traded;
 - (c) it is not in the process of issuing securities in public securities markets; and
 - (d) the immediate or ultimate parent publishes consolidated financial statements that comply with International Financial Reporting Standards.
- to incorporate the consensus in SIC-33, Consolidation and Equity Method – Potential Voting Rights and Allocation of Ownership Interests (paragraphs 12B and 15A), and to withdraw SIC-33.
- to change the criterion for exclusion from the scope of consolidation when control is intended to be temporary from “in the near future” to “within twelve months”(paragraph 13).
- to remove the exclusion from consolidation when a subsidiary operates under severe long-term restrictions that significantly impair its ability to transfer funds to the parent (paragraph 13) and indicate that severe long-term restrictions on the ability to transfer funds to the investor make it unlikely that control exists (paragraph 12A).
- to require use of uniform accounting policies for like transactions and other events in similar circumstances and not have a practicability exemption (paragraph 21).
- to require minority interests to be presented in the consolidated balance sheet within equity, separately from the parent shareholders’ equity (paragraph 26).

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

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

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International Accounting Standard IAS 27 (revised 2000 200X)

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

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

Scope

1. This Standard shall ~~should~~ be applied in the preparation and presentation of consolidated financial statements for a group of entities ~~enterprises~~ under the control of a parent.

~~2.-5.~~ This Standard does not deal with:

~~(a)~~ methods of accounting for business combinations and their effects on consolidation, including goodwill arising on a business combination (see IAS 22 (revised 1998), Business Combinations).

~~3.-2.~~ **This Standard shall ~~should~~ also be applied in accounting for investments in subsidiaries, jointly controlled entities and associates in the ~~a parent's~~ separate financial statements of a parent, venturer or investor.**

4. Separate financial statements are financial statements prepared in addition to consolidated financial statements prepared in accordance with the requirements of this Standard, or in addition to financial statements prepared in accordance with the requirements in IAS 31, Financial Reporting of Interests in Joint Ventures, or in IAS 28, Investments in Associates. Separate financial statements are also those financial statements described in paragraphs 8 and 9.

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

Definitions

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

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

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

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

A group is a parent and all its subsidiaries.

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

Minority interest is that portion part of the profit or loss net results of operations and of net assets of a subsidiary attributable to equity

interests ~~that which~~ are not owned, directly or indirectly through subsidiaries, by the parent.

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

Presentation of Consolidated Financial Statements

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

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

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

~~*The name and registered office of its parent that publishes consolidated financial statements should also be disclosed.*~~

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

Scope of Consolidated Financial Statements

11. ~~A parent which issues *e*Consolidated financial statements shall should consolidate a parent and all of its subsidiaries, foreign and domestic, other than those referred to in paragraph 13.~~
12. The consolidated financial statements include all entities ~~enterprises~~ that are controlled by the parent, other than those subsidiaries excluded in accordance with ~~for reasons in~~ paragraph 13. Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than ~~one~~ half of the voting power of an entity ~~enterprise~~ unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Control also exists ~~even~~ when the parent owns ~~one~~ half or less of the voting power of an entity ~~enterprise~~ when there is:¹

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

- (a) power over more than ~~one~~ half of the voting rights by virtue of an agreement with other investors;
- (b) power to govern the financial and operating policies of the entity enterprise under a statute or an agreement;
- (c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or
- (d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

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

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

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

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

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

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

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

Consolidation Procedures

15. In preparing consolidated financial statements, the financial statements of the parent and its subsidiaries are combined on a line-by-line basis by adding together like items of assets, liabilities, equity, income and expenses. In order that the consolidated financial statements present financial information about the group as that of a single economic entity enterprise, the following steps are then taken:
- (a) the carrying amount of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary are eliminated (see IAS 22 (revised 1998), Business Combinations, which ~~also~~ describes the treatment of any resultant goodwill);
 - (b) minority interests in the net profit or loss income of consolidated subsidiaries for the reporting period are identified and adjusted against the income of the group ~~in order~~ to arrive at the net income attributable to the owners of the parent; and
 - (c) minority interests in the net assets of consolidated subsidiaries are identified and presented in the consolidated balance sheet within equity, separately from ~~liabilities and~~ the parent shareholders' equity. Minority interests in the net assets consist of:
 - (i) the amount at the date of the original combination calculated in accordance with IAS 22 (revised 1998), Business Combinations; and

- (ii) the minority's share of changes ~~movements~~ in equity since the date of the combination.

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

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

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

18. Intragroup balances and ~~intragroup~~ intragroup transactions, including revenue sales, expenses and dividends, are eliminated in full. ~~Unrealised p~~ Profits and losses resulting from intragroup transactions that are recognised included in the carrying amount of assets, such as inventory and fixed assets, are eliminated in full. Intragroup losses may indicate an impairment that requires recognition in the consolidated financial statements. ~~Unrealised losses resulting from intragroup transactions that are deducted in arriving at the carrying amount of assets are also eliminated unless cost cannot be recovered.~~ IAS 12, Income Taxes, applies to Timing temporary differences that arise from the elimination of unrealised profits and losses resulting from intragroup transactions are dealt with in accordance with IAS 12, Income Taxes.

19. ***When the financial statements of a subsidiary used in the preparation of consolidated~~ion~~ financial statements are prepared as of drawn up to a different reporting dates from that of the parent, adjustments shall should be made for the effects of significant transactions or other events that occur between those dates and the date of the parent's financial statements. In any case, the difference between the reporting dates of the subsidiary and the parent shall should be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period.***

20. The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements are usually prepared as of drawn up to the same date. When the reporting dates of the parent and a subsidiary are different, the subsidiary often prepares, for consolidation purposes, financial statements as of at the same date as the financial statements of the parent group. When financial statements as of the same date as the parent cannot be prepared without undue cost or effort it is impracticable to do this, financial statements of the subsidiary as of drawn up to a different reporting dates may be used, provided the difference is no greater than three months and adjustments are made for the effects of any significant transactions or events that occur between the different reporting dates. The consistency principle dictates that the length of the reporting periods and any difference in the reporting dates should be the same from period to period.
21. *Consolidated financial statements shall should be prepared using uniform accounting policies for like transactions and other events in similar circumstances. ~~If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.~~*
22. ~~In many cases, if~~ a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements ~~when they are used~~ in preparing the consolidated financial statements.
23. The income and expenses results of operations of a subsidiary are included in the consolidated financial statements as from the date of acquisition; as defined in ~~which is the date on which control of the acquired subsidiary is effectively transferred to the buyer, in accordance with IAS 22 (revised 1998), Business Combinations.~~ The income and expenses results of operations of a subsidiary disposed of are included in the consolidated financial statements income statement until the date of disposal, which is the date on which the parent ceases to ~~have~~ control of the subsidiary. The difference between the proceeds from the disposal of the subsidiary and ~~the its~~ carrying amount as of the date of disposal, including the cumulative amount of any exchange differences that relate to the subsidiary recognised in equity in accordance with IAS 21, The Effects of Changes in Foreign Exchange

~~Rates, of its assets less liabilities as of the date of disposal is recognised in the consolidated income statement as the gain profit or loss on the disposal of the subsidiary. In order to ensure the comparability of the financial statements from one accounting period to the next, supplementary information is often provided about the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date and the results for the reporting period and on the corresponding amounts for the preceding period.~~

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

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

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

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

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

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

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

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

Cost Method

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

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

~~(a) carried at cost;~~

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

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

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

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

Disclosure

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

~~(a) in consolidated financial statements a listing of significant subsidiaries including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held;~~

~~(b) in consolidated financial statements, where applicable:~~

- (a*i*) the fact that a subsidiary is not consolidated, in accordance with paragraph 13 of this Standard, because control is temporary the reasons for not consolidating a subsidiary;
 - (b) summarised financial information of subsidiaries that are not consolidated, either individually or in groups, including the amounts of total assets, total liabilities, revenues and profit or loss;
 - (c*ii*) the nature of the relationship between the parent and a subsidiary of which the parent does not own, directly or indirectly through subsidiaries, more than ~~one~~ half of the voting power;
 - (d*iii*) the name of for an investee enterprise in of which more than ~~one~~ half of the voting or potential voting power is owned, directly or indirectly through subsidiaries, but which, because of the absence of control, is not a subsidiary, the reasons why the ownership does not constitute control; ~~and~~
 - (iv) the effect of the acquisition and disposal of subsidiaries on the financial position at the reporting date, the results for the reporting period and on the corresponding amounts for the preceding period; and
 - (e) the reporting date of the financial statements of a subsidiary when such financial statements are used to prepare consolidated financial statements and are as of a reporting date or for a period that is different from that of the parent, and the reason for using a different reporting date or different period; and
 - (f) the nature and extent of any restrictions on the ability of subsidiaries to transfer funds to the parent in the form of cash dividends, repayment of loans or advances (ie borrowing arrangements, regulatory restraints etc).
 - (e) in the parent's separate financial statements, a description of the method used to account for subsidiaries.
33. The following disclosures shall be made in the investor's separate financial statements and in the financial statements of a parent that need not present consolidated financial statements:
- (a) the reasons why separate financial statements are prepared;

- (b) the name of the immediate or ultimate parent and a reference to the consolidated financial statements and or the financial statements in which associates and jointly controlled entities are accounted for under the equity method or proportionate consolidation method in accordance with IAS 28, Accounting for Investments in Associates, and IAS 31, Financial Reporting of Interests in Joint Ventures; and
- (c) a description of the method used to account for investments in subsidiaries, associates and jointly controlled entities.

Effective Date

3334. This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact. This International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1990.

Appendix

Basis for Conclusions (Revisions 200X)

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

Exemption from preparing consolidated financial statements

- A3. Paragraph 8 of IAS 27 (revised 2000) permits wholly-owned and virtually wholly-owned subsidiaries to be excluded from the requirements of preparing consolidated financial statements. The Board considered whether to withdraw this exemption.
- A4. The Board decided to retain the exemption, so that companies in a group that are required by law to publish financial statements under IASs in addition to the group's consolidated financial statements would not be unduly burdened.
- A5. The Board noted that in some circumstances users can find sufficient information for their purposes regarding a subsidiary from either its separate financial statements or the group's consolidated financial statements. In addition, the users of financial statements of a subsidiary often have, or can get access to, more information.
- A6. Having agreed to retain the exemption, the Board decided to propose modifying the exemption as described in paragraph 8 of this Exposure

Draft. Among other things, the Board proposes to extend the exemption to a parent that is not wholly owned if the owners of the minority interest, including those not otherwise entitled to vote, unanimously agree. The Board noted that there is no reason why the exemption should not be extended when all the owners are content not to have consolidated financial statements.

Minority interests

- A7. Minority interest is defined in IAS 27 and IAS 22 (revised 1998), Business Combinations, as that part of the net results of operations and of net assets of a subsidiary attributable to interests, which are not owned, directly or indirectly through subsidiaries, by the parent. Paragraph 26 of IAS 27 requires that minority interests be presented in the consolidated balance sheet separately from liabilities and the parent shareholders' equity. The Board considered whether to amend this requirement.
- A8. The Board decided to propose a modification that minority interests be presented in the consolidated balance sheet within equity, separately from the parent shareholders' equity. The Board noted that a minority interest is not a liability of a group because it does not meet the definition of a liability in the Framework for the Preparation and Presentation of Financial Statements.
- A9. Paragraph 49(b) of the Framework states that a liability is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits. Paragraph 60 of the Framework further indicates that an essential characteristic of a liability is that the entity has a present obligation and that an obligation is a duty or responsibility to act or perform in a particular way. The Board noted that the existence of a minority interest in the net assets of a subsidiary does not give rise to a present obligation of the group, the settlement of which is expected to result in an outflow of economic benefits from the group.
- A10. Rather, the Board noted that a minority interest represents the residual interest in the net assets of those subsidiaries held by some of the shareholders of the subsidiaries within the group, and therefore meets the Framework's definition of equity. Paragraph 49(c) of the

Framework states that equity is the residual interest in the assets of the entity after deducting all its liabilities.

- A11. The Board noted that although there could potentially be a number of consequences to the classification of minority interests, it does not propose any change in the recognition and measurement of minority interests at present. Issues on the recognition and measurement of minority interests are being addressed as part of the Business Combinations project (phase II).

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

- A12. Paragraph 29 of IAS 27 permits three alternatives on the measurement in a parent's separate financial statements of investments in subsidiaries included in consolidated financial statements—cost, the equity method, or as available-for-sale financial assets under IAS 39 (revised 2000), Financial Instruments: Recognition and Measurement. Paragraph 12 of IAS 28 (revised 2000), Accounting for Investments in Associates, permits the same alternatives for investments in associates in separate financial statements, and paragraph 38 of IAS 31 (revised 2000) indicates that IAS 31 does not indicate a preference for any particular treatment for accounting for interests in jointly controlled entities in a venturer's separate financial statements. The Board decided to require use of cost or IAS 39 in the investor's separate financial statements prepared in addition to the financial statements presenting the group as a single economic entity.
- A13. Although the equity method would provide users with profit and loss information similar to that obtained from consolidation, the Board noted that such information is reflected in the investor's economic entity financial statements and is not relevant to users of its separate financial statements prepared in addition to those economic entity financial statements. On the other hand, separate financial statements prepared using either the fair value method required by IAS 39 or the cost method would be relevant. Using the fair value method required by IAS 39 would provide an indication of current value. Using the cost method also results in relevant information, depending on the purpose of preparing the separate financial statements. For example, lenders to the parent might be more interested in seeing the dividend

income from subsidiaries as would be presented under the cost method.

- A14. Regarding subsidiaries that are not consolidated under paragraph 13 of IAS 27, paragraph 30 of IAS 27 permits the same alternatives as are permitted for those included in consolidation—cost, the equity method, or as available-for-sale financial assets under IAS 39. The Board considered whether to eliminate one or more of these choices and decided to propose requiring use of IAS 39, which achieves consistency with the treatment of these subsidiaries in consolidated financial statements. The Board noted that there is no reason to require any method that is not used in the consolidated financial statements.

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

Accounting for Investments in Associates

International Accounting Standard IAS 28

(revised 200X)

Accounting for Investments in Associates

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

Invitation to Comment

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

Question 1

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

Question 2

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

Summary of Main Changes

The main changes proposed are:

- to exclude from the scope of IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, investments that would otherwise be associates or joint ventures held by venture capital organisations, mutual funds, unit trusts and similar entities that are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries (paragraph 1).
- to incorporate the consensus in SIC-33, Consolidation and Equity Method – Potential Voting Rights and Allocation of Ownership Interests (paragraph 5A) and to withdraw SIC-33.
- to change the criterion regarding when an investment is held exclusively with a view to its subsequent disposal from “in the near future” to “within twelve months” (paragraph 8).
- to remove the exclusion from equity accounting when an investee operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor (paragraph 8) and indicate that severe long-term restrictions on the ability to transfer funds to the investor may preclude significant influence (paragraph 5B).
- to require use of the equity method for an investment in an associate when an investor does not prepare consolidated financial statements because it does not have any subsidiaries (paragraph 8).
- to deal with the measurement of investments in associates in an investor’s separate financial statements in IAS 27, Consolidation and Separate Financial Statements (paragraph 12).
- to incorporate the consensus in SIC-3, Elimination of Unrealised Profits and Losses on Transactions with Associates (paragraph 16B).
- to require that when financial statements of an associate used in applying the equity method are prepared as of a reporting date that is different from that of an investor, the difference shall be no greater than three months (paragraph 18).

- to require use of uniform accounting policies for like transactions and events in similar circumstances (paragraph 20).
- to require that the amount to be reduced to nil when an associate incurs losses shall include not only investments in the equity of the associate but also other long-term interests (paragraph 22) and to withdraw SIC-20, Equity Accounting Method – Recognition of Losses.
- to require additional disclosures (paragraphs 27-28B).

Contents

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

Accounting for Investments in Associates

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APPENDIX: Basis for Conclusions (Revisions 200X)

International Accounting Standard IAS 28

(revised ~~2000~~ 200X)

Accounting for Investments in Associates

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

Scope

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

Definitions

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

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

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

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

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

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

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

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

Significant Influence

4. If an investor holds, directly or indirectly through subsidiaries, 20 per cent % or more of the voting power of the investee, it is presumed that the investor has ~~does have~~ significant influence, unless it can be clearly demonstrated that this is not the case. Conversely, if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent % of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated. A substantial or majority ownership by another investor does not necessarily preclude an investor from having significant influence.
5. The existence of significant influence by an investor is usually evidenced in one or more of the following ways:
 - (a) representation on the board of directors or equivalent governing body of the investee;
 - (b) participation in policy-making processes;

- (c) material transactions between the investor and the investee;
- (d) interchange of managerial personnel; or
- (e) provision of essential technical information.

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

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

Equity Method

6. Under the equity method, the investment is initially recognised ~~recorded~~ at cost and the carrying amount is increased or decreased to recognise the investor's share of the profits or losses of the investee after the date of acquisition. The investor's share of the profit or loss of the investee is included in the investor's profit or loss. Distributions received from an investee reduce the carrying amount of the investment. Adjustments to the carrying amount may also be necessary for changes ~~alterations~~ in the investor's proportionate interest in the investee arising from changes in the investee's equity that have not been included in the investee's profit or loss ~~the income statement~~. Such changes include those arising from the revaluation of property, plant, and equipment ~~and investments~~, and from foreign exchange translation differences ~~and from the adjustment of differences arising on business combinations~~. The investor's share of those changes is recognised directly in equity of the investor.

Cost Method

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

Application of the Equity Method Consolidated Financial Statements

8. *An investment in an associate shall ~~should~~ be accounted for in consolidated financial statements under the equity method except when:*

- (a) *~~the investment is acquired and held exclusively with a view to its subsequent disposal within twelve months from acquisition, in the near future; or~~*
- (b) *~~it operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.~~*

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

- 8A. An investor accounts for an investment in an associate using the equity method irrespective of whether the investor also has investments in subsidiaries or whether it describes its financial statements as consolidated financial statements.
9. The recognition of income on the basis of distributions received may not be an adequate measure of the income earned by an investor on an investment in an associate because the distributions received may bear little relationship to the performance of the associate. Because ~~As~~ the investor has significant influence over the associate, the investor has a measure of responsibility for the associate's performance and, as a result, the return on its investment. The investor accounts for this stewardship by extending the scope of its ~~consolidated~~ financial statements to include its share of profits or losses ~~results~~ of such an

associate and so provides an analysis of earnings and investment from which more useful ratios can be calculated. As a result, the application of the equity method provides more informative reporting of the net assets and net profit or loss ~~income~~ of the investor.

10. [Deleted]
11. *An investor shall ~~should~~ discontinue the use of the equity method from the date that:*
- (a) ~~it ceases to have significant influence over in an associate but retains, either in whole or in part, its investment; or and shall account for the investment in accordance with IAS 39, Financial Instruments: Recognition and Measurement, from the date that it ceases to be an associate.~~*
- (b) ~~the use of the equity method is no longer appropriate because the associate operates under severe long-term restrictions that significantly impair its ability to transfer funds to the investor.~~*
- IIA.** *The carrying amount of the investment at ~~the~~ date that it ceases to be an associate shall ~~should~~ be regarded as its cost on initial measurement as a financial asset under IAS 39, Financial Instruments: Recognition and Measurement thereafter.*

Separate Financial Statements of the Investor

12. ~~[Deleted] An investment in an associate that is included in the separate financial statements of an investor that issues consolidated financial statements and that is not held exclusively with a view to its disposal in the near future should be either:~~
- ~~(a) carried at cost;~~
- ~~(b) accounted for using the equity method as described in this Standard; or~~
- ~~(c) accounted for as an available-for-sale financial asset as described in IAS 39, Financial Instruments: Recognition and Measurement.~~
13. ~~[Deleted] The preparation of consolidated financial statements does not, in itself, obviate the need for separate financial statements for an investor.~~

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

~~Application of the Equity Method~~

16. Many of the procedures appropriate for the application of the equity method are similar to the consolidation procedures ~~described set out~~ in IAS 27, Consolidated and Separate Financial Statements ~~and Accounting for Investments in Subsidiaries~~. Furthermore, the ~~broad~~ concepts underlying the ~~consolidation~~ procedures used in the acquisition of a subsidiary are also adopted on the acquisition of an investment in an associate.[†]
- 16A. A group's interest in an associate is the aggregate of the holdings in that associate by the parent and its subsidiaries (excluding those held by minority interests of subsidiaries). The holdings of the group's other associates or joint ventures are ignored for the purpose of applying the equity method. When an associate has subsidiaries, associates, or joint ventures, the profits or losses and net assets taken into account in applying the equity method are those recognised in the associate's consolidated financial statements (including the associate's

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

share of the profits or losses and net assets of its associates and joint ventures), after any adjustments necessary to give effect to the investor's accounting policies (see paragraph 20).

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

17. An investment in an associate is accounted for under the equity method from the date on which it ~~becomes~~ ~~falls within the definition of~~ an associate. On acquisition of the investment any difference (whether positive or negative) between the cost of the investment acquisition and the investor's share of the fair values of the net identifiable assets of the associate is treated as goodwill and is accounted for in accordance with IAS 22 (revised 1998), Business Combinations. Goodwill relating to an associate is included in the carrying amount of the investment. Appropriate adjustments to the investor's share of the profits or losses after acquisition are made to account for:

- (a) depreciation of the depreciable assets, based on their fair values at the date of acquisition; and
- (b) amortisation of the goodwill difference between the cost of the investment and the investor's share of the fair values of the net identifiable assets.

18. When the financial statements of an associate used in applying the equity method are prepared as of a different reporting date from that of the investor, adjustments shall be made for the effects of significant transactions or events that occur between that dates and the date of the investor's financial statements. In any case, the difference between the reporting dates of the associate and of the investor shall be no more than three months. The length of the reporting periods and any difference in the reporting dates shall be the same from period to period. The most recent available financial statements of the associate are used by the investor in applying the equity method; they are usually drawn up to the same date as the

~~*financial statements of the investor. When the reporting dates of the investor and the associate are different, the associate often prepares, for the use of the investor, statements as at the same date as the financial statements of the investor. When it is impracticable to do this, financial statements drawn up to a different reporting date may be used. The consistency principle dictates that the length of the reporting periods, and any difference in the reporting dates, are consistent from period to period.*~~

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

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

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

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

Impairment Losses

23. If there is an indication that an investment in an associate may be impaired, an entity enterprise applies IAS 36, Impairment of Assets.

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

In determining the value in use of the investment, an entity ~~enterprise~~ estimates:

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

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

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

Separate Financial Statements

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

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

Income Taxes

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

Contingencies

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

Disclosure

27. *The following disclosures shall ~~should be~~ made:*
- ~~(a) an appropriate listing and description of significant associates including the proportion of ownership interest and, if different, the proportion of voting power held; and~~
 - ~~(b) the methods used to account for such investments.~~
 - (a) the fair value of investments in associates for which there are published price quotations;*
 - (b) summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss;*
 - (c) the reasons why the presumption that an investor does not have significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, less than 20 per cent of the voting or potential voting power of the investee but concludes that it has significant influence;*
 - (d) the reasons why the presumption that an investor has significant influence is overcome if the investor holds, directly or indirectly through subsidiaries, 20 per cent or more of the voting or potential voting power of the investee but concludes that it does not have significant influence;*
 - (e) the reporting date of the financial statements of an associate, when such financial statements are used in applying the equity method and are as of a reporting date or for a period that is different from that of the investor, and the reason for using a different reporting date or different period;*

(f) the nature and extent of any restrictions on the ability of associates to transfer funds to the investor in the form of cash dividends, repayment of loans or advances (ie borrowing arrangements, regulatory restraint etc);

(g) the unrecognised share of net losses of an associate, both for the period and cumulatively, if an investor has discontinued recognition of its share of losses of an associate.

28. ~~Investments in associates accounted for using the equity method shall be classified as long-term assets and disclosed as a separate item in the balance sheet. The investor's share of the after-tax profit or loss of such associates investments shall be disclosed as a separate item in the income statement. The investor's share of any discontinuing operations of such associates extraordinary or prior period items shall also be separately disclosed.~~

28A. The investor's share of changes in the associate's equity recognised directly in equity by the investor shall be disclosed in the statement of changes in equity required by IAS 1, Presentation of Financial Statements.

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

(a) its share of the contingent liabilities of an associate for which it is also contingently liable; and

(b) those contingent liabilities that arise because the investor is severally liable for all liabilities of the associate.

Effective Date

29. ~~This Standard becomes operative for annual financial statements covering periods beginning on or after 1 January 2003. Earlier adoption is encouraged. If earlier adoption affects the financial statements, an entity shall disclose that fact. Except for paragraphs 23 and 24, this International Accounting Standard becomes operative for financial statements covering periods beginning on or after 1 January 1990.~~

30. ~~[Deleted] Paragraphs 23 and 24 become operative when IAS 36 becomes operative i.e. for annual financial statements covering~~

periods beginning on or after 1 July 1999, unless IAS 36 is applied for earlier periods.

31. ~~[Deleted] Paragraphs 23 and 24 of this Standard were approved in July 1998 to supersede paragraphs 23 and 24 of IAS 28, Accounting for Investments in Associates, reformatted in 1994.~~

Appendix

Basis for Conclusions (Revisions 200X)

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

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

- A3. No Standard specifically deals with the accounting for investments by venture capital organisations, mutual funds, unit trusts and similar entities. As a result, depending on the extent of control or influence over an investee, one of the following Standards is applied:
- (a) IAS 27 (revised 2000), Consolidated Financial Statements and Accounting for Investments in Subsidiaries,
 - (b) IAS 28 (revised 2000), Accounting for Investments in Associates, or
 - (c) IAS 31 (revised 2000), Financial Reporting of Interests in Joint Ventures.
- A4. The Board considered whether another approach is appropriate for these investments and concluded that it is. The Board noted that use of the equity or proportionate consolidation methods for investments by venture capital organisations, mutual funds, unit trusts and similar entities often produces information that is not relevant to their

management and others and that fair value measurement produces more relevant information. The Board also noted that fair value information is often readily available for these investments.

- A5. In addition, the Board noted that there may be frequent changes to the level of influence or control for these investments and that financial statements are less useful if there are frequent changes in the method of accounting for an investment.
- A6. Accordingly, the Board decided to propose that investments by venture capital organisations, mutual funds, unit trusts and similar entities be excluded from the scope of IAS 28 and IAS 31, Financial Reporting of Interests in Joint Ventures, when they are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in the industries involved. The Board understands that use of fair value measurement is a well-established practice for these investments.
- A7. The Board decided, however, that if an investment qualifies as a subsidiary under IAS 27, the investment should be consolidated without exception. The Board concluded that if an investor controls an investee, the investee is part of a group and part of the structure through which the group operates its business and that consolidation of the investee is appropriate.

Recognition of losses

- A8. If an investor's share of losses of an associate equals or exceeds the carrying amount of an investment, IAS 28 and SIC-20, Equity Accounting Method – Recognition of Losses, require applying the equity method only until the carrying amount of the investment is reduced to nil, unless the investor has incurred obligations to the associate or has satisfied obligations of the associate that the investor has guaranteed or to which it is otherwise committed, whether funded or not. SIC-20 indicates that the carrying amount of an investment should include only the carrying amount of instruments that provide unlimited rights of participation in profits or losses and a residual equity interest in the investee.
- A9. The Board considered whether the base to be reduced to nil should be broader. The Board decided to propose requiring the base to include the carrying amount of an investment in equity shares plus other interests such as long-term receivables and therefore to withdraw

SIC-20. The Board notes that, in circumstances in which an investee incurs losses, the substance of particular investments is that they are part of the investment in equity of the investee.

A10. The Board also noted that if non-equity investments are not included in the base to be reduced to nil, an investor could restructure its investment to avoid recognising the loss under the equity method.

Proposed Improvements to International Accounting Standard IAS 33

Earnings Per Share

International Accounting Standard IAS 33
(revised 200X)

Earnings Per Share

Invitation to Comment

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

Question 1

Do you agree that contracts that may be settled either in ordinary shares or in cash, at the issuer's option, should be included as potential ordinary shares in the calculation of diluted earnings per share based on a rebuttable presumption that the contracts will be settled in shares?

Question 2

Do you agree with the following approach to the year-to-date calculation of diluted earnings per share (as illustrated in Appendix B, examples 7 and 12)?

- The number of potential ordinary shares is a year-to-date weighted average of the number of potential ordinary shares included in each interim diluted earnings per share calculation, rather than a year-to-date weighted average of the number of potential ordinary shares weighted for the period they were outstanding (ie without regard for the diluted earnings per share information reported during the interim periods).
- The number of potential ordinary shares is computed using the average market price during the interim periods reported upon, rather than using the average market price during the year-to-date period.
- Contingently issuable shares are weighted for the interim periods in which they were included in the computation of diluted earnings per share, rather than being included in the computation of diluted earnings per share (if the conditions are satisfied) from the beginning of the year-to-date reporting period (or from the date of the contingent share agreement, if later).

Summary of Main Changes

The main changes proposed are:

- to include or exclude contracts that may be settled either in ordinary shares or in cash, at the issuer's option, in the calculation of the number of potential ordinary shares in the diluted earnings per share calculation based on a rebuttable presumption that the contracts will be settled in shares (see paragraphs 51-53). SIC-24 would be withdrawn if this approach were included in the revised Standard.
- to clarify that adjustments are required in calculating basic earnings per share for particular transactions involving an entity's preferred shares or other securities classified as equity instruments. For example, the excess of the consideration paid to acquire preference shares over their carrying amount is deducted in computing the numerator for the purpose of calculating basic earnings per share (see paragraphs 13-16).
- to provide additional guidance and illustrative examples on particular, more complex matters, such as the effects of contingently issuable shares; potential ordinary shares of subsidiaries, joint ventures or associates; participating securities; written put options; and purchased put and call options.

This Exposure Draft proposes extensive changes to IAS 33. Hence, for ease of reading, it is presented as a 'clean' draft rather than a 'marked-up' version that marks the changes.

Appendix A is an integral part of the requirements of the Standard and provides general guidance to be applied in the calculation of earnings per share.

Appendix B has been prepared by the staff of the IASB and was not presented to the IASB Board for approval. Appendix B is illustrative only and does not form part of the Standard. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

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International Accounting Standard IAS 33

(revised 200X)

Earnings Per Share

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

Objective

The objective of this Standard is to prescribe principles for the determination and presentation of earnings per share for profit or loss from continuing operations and for net profit or loss for the period (each for the amount attributable to ordinary shareholders), so as to improve performance comparisons among different entities in the same period and among different accounting periods for the same entity. Even though earnings per share data have limitations because of the different accounting policies that may be used for determining 'earnings', a consistently determined denominator enhances financial reporting. The focus of this Standard is on the denominator of the earnings per share calculation.

Scope

- 1. This Standard shall be applied by entities whose ordinary shares or potential ordinary shares are publicly traded and by entities that are in the process of issuing ordinary shares or potential ordinary shares in public securities markets.***
- 2. An entity that discloses earnings per share shall calculate and disclose earnings per share in accordance with this Standard.***
- 3. An entity that has neither ordinary shares nor potential ordinary shares that are publicly traded is not required to disclose earnings per share. However, in order to maintain comparability in financial reporting**

among entities any such entity that chooses to disclose earnings per share calculates earnings per share in accordance with this Standard.

Definitions

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

An ordinary share is an equity instrument that is subordinate to all other classes of equity instruments.

A potential ordinary share is a financial instrument or other contract that may entitle its holder to ordinary shares.

Warrants or options are financial instruments that give the holder the right to purchase ordinary shares.

Contingently issuable ordinary shares are ordinary shares issuable for little or no cash or other consideration upon the satisfaction of certain conditions pursuant to a contingent share agreement.

Dilution is a reduction in earnings per share or an increase in loss per share resulting from the assumption that convertible securities were converted, that options or warrants were exercised, or that ordinary shares were issued upon the satisfaction of certain conditions.

5. Ordinary shares participate in net profit for the period only after other types of shares such as preference shares. An entity may have more than one class of ordinary shares. Ordinary shares of the same class have the same rights to receive dividends.
6. Examples of potential ordinary shares are:
- (a) debt or equity instruments, including preference shares, that are convertible into ordinary shares;
 - (b) share warrants and options;
 - (c) shares that would be issued upon the satisfaction of conditions resulting from contractual arrangements, such as the purchase of a business or other assets.
7. Terms defined in IAS 32, Financial Instruments: Disclosure and Presentation, are used in this Standard with the meanings specified in IAS 32 (see IAS 32, paragraph 5), unless otherwise noted. IAS 32

defines a financial instrument, financial asset, financial liability, equity instrument, fair value, and market value, and provides guidance on applying those definitions.

Measurement

Basic Earnings Per Share

8. *An entity shall calculate basic earnings per share for profit or loss from continuing operations and for net profit or loss for the period, each for the amount attributable to ordinary shareholders. Basic earnings per share shall be calculated by dividing profit or loss from continuing operations and net profit or loss for the period, each attributable to ordinary shareholders (the numerators) by the weighted average number of ordinary shares outstanding (the denominator) during the period.*
9. The objective of basic earnings per share information is to provide a measure of the interests of each ordinary share in the performance of an entity over the reporting period.

Earnings - Basic

10. *For the purpose of calculating basic earnings per share, profit or loss from continuing operations and net profit or loss for the period attributable to ordinary shareholders shall be profit or loss after deducting or adding, as appropriate, preference dividends, gains or losses on settlement of preference shares, and other similar effects of preference shares that are charged or credited to retained earnings.*
11. All items of income and expense that are recognised in a period, including tax expense and dividends on preferred shares classified as liabilities, and minority interests are included in the determination of net profit or loss for the period (see IAS 1, Presentation of Financial Statements).
12. The amount of preference dividends that is deducted from profit or loss is:
 - (a) the amount of any preference dividends on non-cumulative preference shares declared in respect of the period; and

- (b) the full amount of the required preference dividends for cumulative preference shares for the period, whether or not the dividends have been declared. The amount of preference dividends for the period does not include the amount of any preference dividends for cumulative preference shares paid or declared during the current period in respect of previous periods.
13. Increasing rate preference shares often provide for either a low initial dividend to compensate an entity for selling the preference shares at a discount, or above-market dividends in later periods to compensate investors for purchasing preference shares at a premium. Any original issue discount or premium is amortised to retained earnings using the interest method and treated as a preference dividend for the purposes of calculating earnings per share.
 14. Preference shares may be repurchased pursuant to an entity's tender offer to the holders. The excess of the fair value of the consideration paid to the preference shareholders over the carrying amount of the preference shares represents a return to the holders of the preference shares and a charge to retained earnings for the reporting entity. This loss on settlement of preference shares is deducted in calculating profit or loss attributable to ordinary shareholders.
 15. Early conversion of convertible preference shares may be induced by an entity through favourable changes to the original conversion terms or the payment of additional consideration, or both. The excess of the fair value of the ordinary shares or other consideration paid over the fair value of the ordinary shares issuable pursuant to the original conversion terms is a return to the preference shareholders, and is deducted in calculating profit or loss attributable to ordinary shareholders.
 16. Any gain on the settlement of preferred shares is added in calculating profit or loss attributable to ordinary shareholders.

Per Share - Basic

17. *For the purpose of calculating basic earnings per share, the number of ordinary shares shall be the weighted average number of ordinary shares outstanding during the period.*
18. Using the weighted average number of ordinary shares outstanding during the period reflects the possibility that the amount of shareholders' capital varied during the period as a result of a larger or

lesser number of shares being outstanding at any time. It is the number of ordinary shares outstanding at the beginning of the period, adjusted by the number of ordinary shares bought back or issued during the period multiplied by a time-weighting factor. The time-weighting factor is the number of days that the shares are outstanding as a proportion of the total number of days in the period; a reasonable approximation of the weighted average is adequate in many circumstances.

19. In most cases, shares are included in the weighted average number of shares from the date consideration is receivable (which is generally the date of their issue), for example:
 - (a) ordinary shares issued in exchange for cash are included when cash is receivable;
 - (b) ordinary shares issued on the voluntary reinvestment of dividends on ordinary or preference shares are included when dividends are reinvested;
 - (c) ordinary shares issued as a result of the conversion of a debt instrument to ordinary shares are included from the date that interest ceases accruing;
 - (d) ordinary shares issued in place of interest or principal on other financial instruments are included from the date that interest ceases accruing;
 - (e) ordinary shares issued in exchange for the settlement of a liability of the entity are included from the settlement date;
 - (f) ordinary shares issued as consideration for the acquisition of an asset other than cash are included as of the date on which the acquisition is recognised; and
 - (g) ordinary shares issued for the rendering of services to the entity are included as the services are rendered.

In these and other cases, the timing of the inclusion of ordinary shares is determined by the terms and conditions attaching to their issue. Due consideration is given to the substance of any contract associated with the issue.

20. Ordinary shares issued as part of the purchase consideration of a business combination that is an acquisition are included in the weighted average number of shares from the date of the acquisition

because the acquirer incorporates the results of the operations of the acquiree into its income statement from that date. Ordinary shares issued as part of a business combination that is a uniting of interests are included in the calculation of the weighted average number of shares for all periods presented because the financial statements of the combined entity are prepared as if the combined entity had always existed. Therefore, the number of ordinary shares used for the calculation of basic earnings per share in a business combination that is a uniting of interests is the aggregate of the weighted average number of shares of the combined entities, adjusted to equivalent shares of the entity whose shares are outstanding after the combination.

21. Contingently issuable shares are treated as outstanding, and are included in the calculation of basic earnings per share, only from the date when all necessary conditions are satisfied (ie the events have occurred). Shares that are issuable solely after the passage of time are not contingently issuable shares because the passage of time is a certainty. Outstanding ordinary shares that are contingently returnable (ie subject to recall) are treated as contingently issuable shares (see also paragraphs 45-50).
22. ***The weighted average number of ordinary shares outstanding during the period and for all periods presented shall be adjusted for events, other than the conversion of potential ordinary shares, that have changed the number of ordinary shares outstanding without a corresponding change in resources.***
23. Ordinary shares may be issued, or the number of ordinary shares outstanding may be reduced, without a corresponding change in resources. Examples include:
 - (a) a capitalisation or bonus issue (sometimes referred to as a stock dividend);
 - (b) a bonus element in any other issue, for example a bonus element in a rights issue to existing shareholders;
 - (c) a share split; and
 - (d) a reverse share split (consolidation of shares).
24. In a capitalisation or bonus issue or a share split, ordinary shares are issued to existing shareholders for no additional consideration. Therefore, the number of ordinary shares outstanding is increased without an increase in resources. The number of ordinary shares

outstanding before the event is adjusted for the proportionate change in the number of ordinary shares outstanding as if the event had occurred at the beginning of the earliest period presented. For example, on a two-for-one bonus issue, the number of ordinary shares that are outstanding before the issue is multiplied by three to obtain the new total number of ordinary shares, or by two to obtain the number of additional ordinary shares.

25. A consolidation of ordinary shares generally reduces the number of ordinary shares outstanding without a corresponding reduction in resources. However, where a share consolidation is combined with a special dividend and the overall effect is a share repurchase at fair value, the reduction in the number of ordinary shares outstanding is the result of a corresponding reduction in resources. The weighted average number of ordinary shares outstanding for the period in which the combined transaction takes place is adjusted for the reduction in the number of ordinary shares from the date the special dividend is recognised.

Diluted Earnings Per Share

26. *For the purpose of calculating diluted earnings per share, profit or loss from continuing operations and net profit or loss for the period, each for the amount attributable to ordinary shareholders, and the weighted average number of shares outstanding shall be adjusted for the effects of all dilutive potential ordinary shares.*
27. The objective of diluted earnings per share is consistent with that of basic earnings per share. Accordingly, the calculation of diluted earnings per share is consistent with the calculation of basic earnings per share while also giving effect to all dilutive potential ordinary shares outstanding during the period. As a result:
- (a) profit or loss attributable to ordinary shareholders is increased by the after-tax amount of dividends and interest recognised in the period in respect of the dilutive potential ordinary shares and adjusted for any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares; and
 - (b) the weighted average number of ordinary shares outstanding is increased by the weighted average number of additional ordinary

shares that would have been outstanding assuming the conversion of all dilutive potential ordinary shares.

Earnings - Diluted

28. *For the purpose of calculating diluted earnings per share, the amount of profit or loss attributable to ordinary shareholders, as calculated in accordance with paragraph 10, shall be adjusted by the after-tax effect of:*
- (a) *any dividends or other items related to dilutive potential ordinary shares deducted in arriving at profit or loss attributable to ordinary shareholders as calculated in accordance with paragraph 10;*
 - (b) *any interest recognised in the period related to dilutive potential ordinary shares; and*
 - (c) *any other changes in income or expense that would result from the conversion of the dilutive potential ordinary shares.*
29. After the potential ordinary shares are converted into ordinary shares, the items identified in paragraph 28(a)-(c) no longer arise. Instead, the new ordinary shares are entitled to participate in profit or loss attributable to ordinary shareholders. Therefore, profit or loss attributable to ordinary shareholders calculated in accordance with paragraph 10 is adjusted for the items identified in paragraph 28(a)-(c) and any related taxes. The expenses associated with potential ordinary shares include fees and amortisation of discounts accounted for as yield adjustments (see IAS 32).
30. The conversion of potential ordinary shares may lead to consequential changes in income or expenses. For example, the reduction of interest expense related to potential ordinary shares and the resulting increase in profit or loss may lead to an increase in the expense related to a non-discretionary employee profit-sharing plan. For the purpose of calculating diluted earnings per share, profit or loss attributable to ordinary shareholders is adjusted for any such consequential changes in income or expense.

Per Share - Diluted

31. *For the purpose of calculating diluted earnings per share, the number of ordinary shares shall be the weighted average number of*

ordinary shares calculated in accordance with paragraphs 17 and 22, plus the weighted average number of ordinary shares that would be issued on the conversion of all the dilutive potential ordinary shares into ordinary shares. Dilutive potential ordinary shares shall be deemed to have been converted into ordinary shares at the beginning of the period or, if later, the date of the issue of the potential ordinary shares.

32. Potential ordinary shares are weighted for the period they are outstanding. Potential ordinary shares that are cancelled or allowed to lapse during the period are included in the calculation of diluted earnings per share only for the portion of the period during which they are outstanding. Potential ordinary shares that are converted into ordinary shares during the period are included in the calculation of diluted earnings per share from the beginning of the period to the date of conversion; from the date of conversion, the resulting ordinary shares are included in both basic and diluted earnings per share.
33. The number of ordinary shares that would be issued on conversion of dilutive potential ordinary shares is determined from the terms of the potential ordinary shares. When more than one basis of conversion exists, the calculation assumes the most advantageous conversion rate or exercise price from the standpoint of the holder of the potential ordinary shares.
34. A subsidiary, joint venture or associate may issue to parties other than the parent, venturer or investor potential ordinary shares that are convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the parent, venturer or investor (the reporting entity). If these potential ordinary shares of the subsidiary, joint venture or associate have a dilutive effect on the basic earnings per share of the reporting entity, they are included in the calculation of diluted earnings per share.
35. *For the purpose of calculating diluted earnings per share, an entity shall assume the exercise of dilutive options and other dilutive potential ordinary shares of the entity. The assumed proceeds from these issues shall be regarded as having been received from the issue of ordinary shares at fair value. The difference between the number of ordinary shares issued and the number of ordinary shares that would have been issued at fair value shall be treated as an issue of ordinary shares for no consideration.*

36. Fair value for the purpose of calculating diluted earnings per share is the average market price of the ordinary shares during the period.

Dilutive Potential Ordinary Shares

37. *Potential ordinary shares shall be treated as dilutive when, and only when, their conversion to ordinary shares would decrease earnings per share from continuing operations.*
38. An entity uses profit or loss from continuing operations as the control number to establish whether potential ordinary shares are dilutive or anti-dilutive. The profit or loss from continuing operations is adjusted in accordance with paragraph 10 and excludes items relating to discontinuing operations.
39. Potential ordinary shares are anti-dilutive when their conversion to ordinary shares would increase earnings per share from continuing operations or decrease loss per share from continuing operations. The calculation of diluted earnings per share does not assume conversion, exercise, or other issue of potential ordinary shares that would have an anti-dilutive effect on earnings per share.
40. In considering whether potential ordinary shares are dilutive or anti-dilutive, each issue or series of potential ordinary shares is considered separately rather than in aggregate. The sequence in which potential ordinary shares are considered may affect whether they are dilutive. Therefore, to maximise the dilution of basic earnings per share, each issue or series of potential ordinary shares is considered in sequence from the most dilutive to the least dilutive, ie dilutive potential ordinary shares with the lowest 'earnings per incremental share' are included in the diluted earnings per share calculation before those with a higher earnings per incremental share. Options and warrants are generally included first because they do not impact the numerator of the calculation.
41. The redemption or induced conversion of convertible preference shares may affect only a portion of the previously outstanding convertible preference shares. In such cases, any excess consideration referred to in paragraph 15 is attributed to those shares that are redeemed or converted for the purpose of determining whether the remaining outstanding preference shares are dilutive. The shares redeemed or converted are considered separately from those shares that are not redeemed or converted.

Options, warrants and their equivalents

42. Options, warrants and their equivalents (herein referred to as options and warrants) are dilutive when they would result in the issue of ordinary shares for less than fair value. The amount of the dilution is fair value minus the issue price. Therefore, to calculate diluted earnings per share, each potential ordinary share is treated as consisting of both the following:
- (a) a contract to issue ordinary shares at their average market price during the period. Such ordinary shares are assumed to be fairly priced and to be neither dilutive nor anti-dilutive. They are ignored in the calculation of diluted earnings per share.
 - (b) a contract to issue the remaining ordinary shares for no consideration. Such ordinary shares generate no proceeds and have no effect on profit or loss attributable to ordinary shares outstanding. Therefore, such shares are dilutive and are added to the number of ordinary shares outstanding in the calculation of diluted earnings per share.
43. Options and warrants have a dilutive effect only when the average market price of the ordinary shares during the period exceeds the exercise price of the options or warrants (ie they are 'in the money'). Previously reported earnings per share are not retroactively adjusted to reflect changes in prices of ordinary shares.
44. Employee share options with fixed or determinable terms and non-vested ordinary shares are treated as options in the calculation of diluted earnings per share, even though they may be contingent on vesting. They are treated as outstanding on the grant date. Performance-based employee share options are treated as contingently issuable shares because their issue is contingent upon satisfying specified conditions in addition to the passage of time.

Contingently issuable shares

45. As in the calculation of basic earnings per share, contingently issuable ordinary shares are treated as outstanding and included in the calculation of diluted earnings per share if the conditions are satisfied (ie the events have occurred). Contingently issuable shares are included from the beginning of the period (or from the date of the contingent share agreement, if later). If the conditions are not met, the number of contingently issuable shares included in the diluted earnings per share calculation is based on the number of shares that

would be issuable if the end of the period were the end of the contingency period. Restatement is not permitted if the conditions are not met when the contingency period expires.

46. If attainment or maintenance of a specified amount of earnings is the condition and if that amount has been attained, the additional ordinary shares are treated as outstanding when calculating diluted earnings per share if the effect is dilutive. The diluted earnings per share calculation includes those ordinary shares that would be issued under the conditions of the contract based on the assumption that the current amount of earnings does not change until the end of the agreement, but only if the effect is dilutive. Given that the amount of earnings may change in a future period, the calculation of basic earnings per share does not include such contingently issuable ordinary shares because not all necessary conditions have been satisfied.
47. The number of ordinary shares contingently issuable may depend on the future market price of the ordinary shares. In that case, calculations of diluted earnings per share reflect the number of ordinary shares that would be issued based on the market price at the end of the reporting period if the effect is dilutive. If the condition is based on an average of market prices over a period of time, the average for that period is used. As the market price may change in a future period, the calculation of basic earnings per share does not include such contingently issuable ordinary shares because all necessary conditions have not been satisfied.
48. In some cases, the number of ordinary shares contingently issuable may depend on both future earnings and future prices of the ordinary shares. In that case, the number of ordinary shares included in the diluted earnings per share calculation is based on both conditions, ie earnings to date and the current market price at the end of the period. If both conditions are not met at the end of the period, no contingently issuable ordinary shares are included in the diluted earnings per share calculation.
49. If the contingency is based on a condition other than earnings or market price (for example, opening a specific number of retail stores), the contingent ordinary shares are included in the calculation of diluted earnings per share based on the assumption that the present status of the condition remains unchanged until the end of the contingency period.

50. Contingently issuable potential ordinary shares (other than those covered by a contingent share agreement, such as contingently issuable convertible securities) are included in the diluted earnings per share calculation as follows:
- (a) an entity determines whether the potential ordinary shares may be assumed to be issuable based on the conditions specified for their issue pursuant to the contingent ordinary share provisions in paragraphs 45-49.
 - (b) if those potential ordinary shares should be reflected in diluted earnings per share, an entity determines their impact on the calculation of diluted earnings per share by following the provisions for convertible securities in paragraphs 28-33, the provisions for options and warrants in paragraphs 42-44, the provisions for contracts that may be settled either in shares or cash in paragraphs 51-53, or other provisions, as appropriate.

However, exercise or conversion is not assumed for the purpose of calculating diluted earnings per share unless exercise or conversion of similar outstanding potential ordinary shares that are not contingently issuable is assumed.

Contracts that may be settled in ordinary shares or cash

51. *When an entity has issued a contract that may be settled either in ordinary shares or in cash at the entity's option, how that contract is reflected in the calculation of diluted earnings per share shall be based on the facts available each period as follows:*
- (a) *the entity shall presume that the contract will be settled in ordinary shares, and the resulting potential ordinary shares shall be included in diluted earnings per share if the effect is dilutive.*
 - (b) *when such a contract is presented for accounting purposes as an asset or a liability, or has both an equity component and a liability component, the entity shall adjust the numerator for any changes in profit or loss that would have resulted during the period if the contract had been classified wholly as an equity instrument. That adjustment is similar to the adjustments required in paragraph 28.*
 - (c) *the presumption that the contract will be settled in ordinary shares may be overcome if past experience or a stated policy*

provides a reasonable basis to believe that the contract will be settled partially or wholly in cash. In such circumstances, if the contract is presented as an equity instrument or has both an equity component and a liability component, the numerator shall be adjusted for any changes in profit or loss that would have resulted during the period if the contract had been classified wholly as an asset or a liability.

52. *For contracts that may be settled either in ordinary shares or in cash at the holder's option, the more dilutive of cash settlement and share settlement shall be used in calculating diluted earnings per share.*
53. An example of a contract that may be settled either in ordinary shares or in cash is a debt security that, on maturity, gives the entity the unrestricted right to settle the principal amount either in cash or in its own ordinary shares. Another example is a written put option that gives the holder a choice of settling in ordinary shares or in cash.

Purchased options

54. Contracts such as purchased put options and purchased call options (ie options held by the entity on its own ordinary shares) are not included in the calculation of diluted earnings per share because including them would be anti-dilutive. The put option would be exercised only if the exercise price were higher than the market price and the call option would be exercised only if the exercise price were lower than the market price.

Written put options

55. *Contracts that require the reporting entity to repurchase its own shares, such as written put options and forward purchase contracts, are reflected in the calculation of diluted earnings per share if the effect is dilutive. If these contracts are 'in the money' during the period (ie the exercise or settlement price is above the average market price for that period), the potential dilutive effect on earnings per share shall be calculated as follows:*
- (a) it shall be assumed that at the beginning of the period sufficient ordinary shares will be issued (at the average market price during the period) to raise proceeds to satisfy the contract;*
 - (b) it shall be assumed that the proceeds from the issue are used to satisfy the contract (ie to buy back ordinary shares); and*

- (c) *the incremental ordinary shares (the difference between the number of ordinary shares assumed issued and the number of ordinary shares received from satisfying the contract) shall be included in the diluted earnings per share calculation.*

Restatement

56. *If the number of ordinary or potential ordinary shares outstanding increases as a result of a capitalisation, bonus issue or share split, or decreases as a result of a reverse share split, the calculation of basic and diluted earnings per share for all periods presented shall be adjusted retrospectively. If these changes occur after the balance sheet date but before issue of the financial statements, the per share calculations for those and any prior period financial statements presented shall be based on the new number of shares. The fact that per share calculations reflect such changes in the number of shares shall be disclosed. In addition, basic and diluted earnings per share of all periods presented shall be adjusted for:*
- (a) *the effects of errors and adjustments resulting from changes in accounting policies, accounted for retrospectively; and*
- (b) *the effects of a business combination that is a uniting of interests.*
57. An entity does not restate diluted earnings per share of any prior period presented for changes in the assumptions used in earnings per share calculations or for the conversion of potential ordinary shares into ordinary shares.

Presentation

58. *An entity shall present basic and diluted earnings per share for profit or loss from continuing operations and net profit or loss for the period on the face of the income statement for each class of ordinary shares that has a different right to share in net profit for the period. An entity shall present basic and diluted earnings per share with equal prominence for all periods presented.*
59. Earnings per share are presented for all periods for which an income statement is presented. If diluted earnings per share is reported for at least one period, it should be reported for all periods presented, even if

it equals basic earnings per share. If basic and diluted earnings per share are equal, dual presentation can be accomplished in one line on the income statement.

60. *An entity that reports a discontinuing operation shall disclose the basic and diluted amounts per share for this line item either on the face of the income statement or in the notes to the financial statements.*
61. *This Standard requires an entity to present basic and diluted earnings per share, even if the amounts disclosed are negative (a loss per share).*

Disclosure

62. *An entity shall disclose the following:*
 - (a) *the amounts used as the numerators in calculating basic and diluted earnings per share, and a reconciliation of those amounts to net profit or loss for the period. The reconciliation shall include the effect of all securities that affect earnings per share.*
 - (b) *the weighted average number of ordinary shares used as the denominator in calculating basic and diluted earnings per share, and a reconciliation of these denominators to each other. The reconciliation shall include the effect of all securities that affect earnings per share.*
 - (c) *securities (including contingently issuable shares) that could potentially dilute basic earnings per share in the future, but were not included in the calculation of diluted earnings per share because they are anti-dilutive for the period(s) presented.*
 - (d) *a description of ordinary share transactions or potential ordinary share transactions, other than capitalisation or bonus issues, share splits or reverse share splits, that occur after the balance sheet date but before issue of the financial statements that would have changed significantly the number of ordinary shares or potential ordinary shares outstanding at the end of the period if those transactions had occurred before the end of the reporting period.*

63. Examples of transactions mentioned in paragraph 62(d) include:
- (a) an issue of shares for cash;
 - (b) an issue of shares when the proceeds are used to repay debt or preference shares outstanding at the balance sheet date;
 - (c) the redemption of ordinary shares outstanding;
 - (d) the conversion or exercise of potential ordinary shares outstanding at the balance sheet date into ordinary shares;
 - (e) an issue of warrants, options, or convertible securities; and
 - (f) the achievement of conditions that would result in the issue of contingently issuable shares.

Earnings per share amounts are not adjusted for such transactions occurring after the balance sheet date because such transactions do not affect the amount of capital used to produce net profit or loss for the period.

64. Financial instruments and other contracts generating potential ordinary shares may incorporate terms and conditions that affect the measurement of basic and diluted earnings per share. These terms and conditions may determine whether any potential ordinary shares are dilutive and, if so, the effect on the weighted average number of shares outstanding and any consequent adjustments to profit or loss attributable to ordinary shareholders. The disclosure of the terms and conditions of such financial instruments and other contracts is encouraged, if not otherwise required (see IAS 32).
65. *If an entity discloses, in addition to basic and diluted earnings per share, amounts per share using a reported component of the income statement other than one required by this Standard, such amounts shall be calculated using the weighted average number of ordinary shares determined in accordance with this Standard. Basic and diluted amounts per share relating to such a component shall be disclosed with equal prominence and presented in the notes to the financial statements. An entity shall indicate the basis on which the numerator(s) is (are) determined, including whether amounts per share are before tax or after tax. If a component of the income statement is used that is not reported as a line item in the income*

statement, a reconciliation shall be provided between the component used and a line item that is reported in the income statement.

66. An entity may disclose more information than this Standard requires. Such information may help users to evaluate the performance of the entity and may take the form of amounts per share for various components of profit or loss. However, when such amounts are disclosed, the denominators are calculated in accordance with this Standard in order to ensure the comparability of the amounts per share disclosed.

Effective Date

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

Appendix A

Application Guidance

This Appendix is an integral part of the requirements of this Standard and provides general guidance to be applied in the calculation of earnings per share.

Rights issues

- A1. The issue of ordinary shares at the time of exercise or conversion of potential ordinary shares do not usually give rise to a bonus element, because the potential ordinary shares are usually issued for full value, resulting in a proportionate change in the resources available to the entity. In a rights issue, the exercise price is often less than the fair value of the shares. Therefore, such a rights issue includes a bonus element. If a rights issue is offered to all existing shareholders, the number of ordinary shares to be used in calculating basic and diluted earnings per share for all periods before the rights issue is the number of ordinary shares outstanding before the issue, multiplied by the following factor:

Fair value per share immediately before the exercise of rights

Theoretical ex-rights fair value per share

The theoretical ex-rights fair value per share is calculated by adding the aggregate market value of the shares immediately before the exercise of the rights to the proceeds from the exercise of the rights, and dividing by the number of shares outstanding after the exercise of the rights. Where the rights are to be publicly traded separately from the shares before the exercise date, fair value for the purposes of this calculation is established at the close of the last day on which the shares are traded together with the rights.

Control number

- A2. To illustrate the application of the control number notion described in paragraphs 38 and 39, assume that an entity has profit from

continuing operations of 4,800, a loss from discontinuing operations of (7,200), a net loss of (2,400), and 2,000 ordinary shares and 400 potential ordinary shares outstanding. The entity's basic earnings per share is 2.40 for continuing operations, (3.60) for discontinuing operations and (1.20) for the net loss. The 400 potential ordinary shares are included in the diluted earnings per share calculation because the resulting 2.00 earnings per share for continuing operations is dilutive, assuming no profit or loss impact of those 400 potential ordinary shares. Because profit from continuing operations is the control number, an entity also includes those 400 potential ordinary shares in the calculation of the other earnings per share amounts, even though the resulting earnings per share amounts are anti-dilutive to their comparable basic earnings per share amounts, ie the loss per share is less [(3.00) per share for the loss from discontinuing operations and (1.00) per share for the net loss].

Average market price of ordinary shares

- A3. For the purpose of calculating diluted earnings per share, the average market price of ordinary shares assumed to be issued is calculated on the basis of the average market price of the ordinary shares during the period. Theoretically, every market transaction for an entity's ordinary shares could be included in the determination of the average market price. As a practical matter, however, a simple average of weekly or monthly prices is usually adequate. Generally, closing market prices are adequate for calculating the average market price. When prices fluctuate widely, however, an average of the high and low prices usually produces a more representative price. The method used to calculate the average market price is used consistently unless it is no longer representative because of changed conditions. For example, an entity that uses closing market prices to calculate the average market price for several years of relatively stable prices might change to an average of high and low prices if prices start fluctuating greatly and the closing market prices no longer produce a representative average price.

Options and warrants and their equivalents

- A4. Options or warrants to purchase convertible securities are assumed to be exercised to purchase the convertible security whenever the average prices of both the convertible security and the ordinary

shares obtainable upon conversion are above the exercise price of the options or warrants. However, exercise is not assumed unless conversion of similar outstanding convertible securities, if any, is also assumed.

- A5. Options or warrants may permit or require the tendering of debt or other securities of the entity (or its parent or a subsidiary) in payment of all or a portion of the exercise price. Those options or warrants have a dilutive effect if (a) the average market price of the related ordinary shares for the period exceeds the exercise price or (b) the selling price of the security to be tendered is below that at which the security may be tendered under the option or warrant agreement and the resulting discount establishes an effective exercise price below the market price of the ordinary shares obtainable upon exercise. In the calculation of diluted earnings per share, those options or warrants are assumed to be exercised and the debt or other securities are assumed to be tendered. If tendering cash is more advantageous to the option or warrant holder and the contract permits tendering cash, tendering of cash is assumed. Interest (net of tax) on any debt assumed to be tendered is added back as an adjustment to the numerator.
- A6. Similar treatment is given to preference shares that have similar provisions or to other securities that have conversion options that permit the investor to pay cash for a more favourable conversion rate.
- A7. The underlying terms of certain options or warrants may require the proceeds received from the exercise of those securities to be applied to redeem debt or other securities of the entity (or its parent or a subsidiary). In the calculation of diluted earnings per share, those options or warrants are assumed to be exercised and the proceeds applied to purchase the debt at its average market price rather than to purchase ordinary shares. However, the excess proceeds received from the assumed exercise over the amount used for the assumed purchase of debt are considered (ie assumed to be used to buy back ordinary shares) in the diluted earnings per share calculation. Interest (net of tax) on any debt assumed to be purchased is added back as an adjustment to the numerator.

Written put options

- A8. To illustrate the application of paragraph 55, assume that an entity has outstanding 120 written put options on its ordinary shares with an exercise price of 35. The average market price of its ordinary shares for the period is 28. In calculating diluted earnings per share, the entity assumes that it issued 150 shares at 28 per share at the beginning of the period to satisfy its put obligation of 4,200. The difference between the 150 ordinary shares issued and the 120 ordinary shares received from satisfying the put option (30 incremental ordinary shares) is added to the denominator in calculating diluted earnings per share.

Securities of subsidiaries, joint ventures or associates

- A9. Potential ordinary shares of a subsidiary, joint venture or associate convertible into either ordinary shares of the subsidiary, joint venture or associate, or ordinary shares of the parent, venturer or investor (the reporting entity) are included in the calculation of diluted earnings per share as follows:
- (a) securities issued by a subsidiary, joint venture or associate that enable their holders to obtain ordinary shares of the subsidiary, joint venture or associate are included in calculating the diluted earnings per share data of the subsidiary, joint venture or associate. Those earnings per share are then included in the earnings per share calculations based on the reporting entity's holding of the securities of the subsidiary, joint venture or associate.
 - (b) securities of a subsidiary, joint venture or associate that are convertible into the reporting entity's ordinary shares are considered among the potential ordinary shares of the reporting entity for the purpose of calculating diluted earnings per share. Likewise, options or warrants issued by a subsidiary, joint venture or associate to purchase ordinary shares of the reporting entity are considered among the potential ordinary shares of the reporting entity in the calculation of consolidated diluted earnings per share.
- A10. For the purpose of determining the earnings per share effect of securities issued by a reporting entity that are convertible into ordinary shares of a subsidiary, joint venture or associate, the

securities are assumed to be converted and the numerator (profit or loss attributable to ordinary shareholders) adjusted as necessary in accordance with paragraph 28. In addition to those adjustments, the numerator is adjusted for any change in the profit or loss recorded by the reporting entity (such as dividend income or equity method income) that is attributable to the increase in the number of ordinary shares of the subsidiary, joint venture or associate outstanding as a result of the assumed conversion. The denominator of the diluted earnings per share calculation is not affected because the number of ordinary shares of the reporting entity outstanding would not change upon assumed conversion.

Participating securities and two-class ordinary shares

A11. The equity of some entities includes:

- (a) securities that participate in dividends with ordinary shares according to a predetermined formula (for example, two for one) with, at times, an upper limit on the extent of participation (for example, up to, but not beyond, a specified amount per share).
- (b) a class of ordinary shares with a different dividend rate from that of another class of ordinary shares but without prior or senior rights.

A12. For the purpose of calculating diluted earnings per share, conversion is assumed for those securities described in paragraph A11 that are convertible into ordinary shares if the effect is dilutive. For those securities that are not convertible into a class of ordinary shares, net profit or loss for the period is allocated to the different classes of shares and participating securities in accordance with their dividend rights or other rights to participate in undistributed earnings. To calculate basic and diluted earnings per share:

- (a) profit or loss attributable to ordinary shareholders is adjusted (a profit reduced and a loss increased) by the amount of dividends declared in the period for each class of shares and by the contractual amount of dividends (or interest on participating bonds) that must be paid for the period (for example, unpaid cumulative dividends).
- (b) the remaining net profit or loss is allocated to ordinary shares and participating securities to the extent that each security shares in earnings as if all of the net profit or loss for the period

had been distributed. The total profit or loss allocated to each class of security is determined by adding together the amount allocated for dividends and the amount allocated for a participation feature.

- (c) the total amount of profit or loss allocated to each class of security is divided by the number of outstanding securities to which the earnings are allocated to determine the earnings per share for the security.

For the calculation of diluted earnings per share, all potential ordinary shares assumed to have been issued are included in outstanding ordinary shares.

Partly paid shares

- A13. Where ordinary shares are issued but not fully paid, they are treated in the calculation of basic earnings per share as a fraction of an ordinary share to the extent that they were entitled to participate in dividends during the period relative to a fully paid ordinary share.
- A14. To the extent that partly paid shares are not entitled to participate in dividends during the period they are treated as the equivalent of warrants or options in the calculation of diluted earnings per share. The unpaid balance is assumed to represent proceeds used to purchase ordinary shares. The number of shares included in diluted earnings per share is the difference between the number of shares subscribed and the number of shares assumed to be purchased.

Appendix B

Illustrative Examples¹

The appendix has been prepared by the staff of the IASB and was not presented to the IASB Board for approval. This appendix is illustrative only and does not form part of the Standard. The purpose of the appendix is to illustrate the application of the standards to assist in clarifying their meaning.

Summary of Examples

Example 1	Increasing Rate Preference Dividends
Example 2	Weighted Average Number of Shares
Example 3	Bonus Issue
Example 4	Convertible Bonds
Example 5	Determining the Order in Which to Include Dilutive Securities in the Calculation of Weighted Average Number of Shares
Example 6	Effects of Share Options on Diluted Earnings Per Share
Example 7	Contingently Issuable Shares
Example 8	Convertible Bonds that may be Settled in Shares or Cash at the Issuer's Option
Example 9	Rights Issue
Example 10	Securities of a Subsidiary: Calculation of Basic and Diluted Earnings per Share
Example 11	Participating Securities and Two-Class Ordinary Shares
Example 12	Calculation of Basic and Diluted Earnings per Share and Income Statement Presentation (Comprehensive Example)

¹ Figures have been rounded for computational purposes.

Example 1 - Increasing Rate Preference Dividends

Entity D issued non-convertible, non-redeemable class A cumulative preference shares of 100 par value on 1 January 20X1. The class A preference shares are entitled to a cumulative annual dividend of 7 per share starting in 20X4.

At the time of issue, the market rate dividend yield on the class A preference shares was 7 per cent a year. Thus, Entity D could have expected to receive proceeds of approximately 100 per class A preference share if the dividend rate of 7 per share had been in effect at the date of issue.

In consideration of the dividend payment terms, however, the class A preference shares were issued at 81.63 per share, ie at a discount of 18.37 per share. The issue price can be calculated by taking the present value of 100, discounted at 7 per cent over a three-year period.

Under paragraph 13 the original issue discount is amortised to retained earnings using the interest method and treated as a preference dividend for earnings per share purposes. To calculate basic earnings per share, the following imputed dividend per class A preference share is deducted as required by paragraph 10 to determine the profit or loss attributable to ordinary shareholders:

	<i>Carrying amount of class A preference shares 1 January</i>	<i>Imputed Dividend</i>	<i>Carrying amount of class A preference shares 31 December²</i>
20X1	81.63	5.71	87.34
20X2	87.34	6.12	93.46
20X3	93.46	6.54	100.00

² Before dividend payment

Example 2 - Weighted Average Number of Shares

		<i>Shares issued</i>	<i>Treasury shares</i>	<i>Shares outstanding</i>
1 January 20X1	Balance at beginning of year	2,000	300	1,700
31 May 20X1	Issue of new shares for cash	800	--	2,500
1 December 20X1	Purchase of treasury shares for cash	--	250	2,250
31 December 20X1	Balance at year-end	<u>2,800</u>	<u>550</u>	<u>2,250</u>

Calculation of weighted average:

$$(1,700 \times 5/12) + (2,500 \times 6/12) + (2,250 \times 1/12) = 2,146 \text{ shares } or$$

$$(1,700 \times 12/12) + (800 \times 7/12) - (250 \times 1/12) = 2,146 \text{ shares}$$

Example 3 - Bonus Issue

Net profit 20X0	180
Net profit 20X1	600
Ordinary shares outstanding until 30 September 20X1	200
Bonus issue 1 October 20X1	2 ordinary shares for each ordinary share outstanding at 30 September 20X1 $200 \times 2 = 400$
Basic earnings per share 20X1	$\frac{600}{(200 + 400)} = 1.00$
Basic earnings per share 20X0	$\frac{180}{(200 + 400)} = 0.30$

Since the bonus issue is an issue without consideration, the issue is treated as if it had occurred before the beginning of 20X0, the earliest period reported.

Example 4 - Convertible Bonds³

Net profit	1,004
Ordinary shares outstanding	1,000
Basic earnings per share	1.00
Convertible bonds	100

Each block of 10 bonds is convertible into 3 ordinary shares

Interest expense for the current year relating to the liability component of the convertible bond	10
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Current and deferred tax relating to that interest expense	4
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Note: the interest expense includes amortisation of the discount arising on initial recognition of the liability component (see IAS 32).

Adjusted net profit	$1,004 + 10 - 4 = 1,010$
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Number of ordinary shares resulting from conversion of bond	30
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Number of ordinary shares used to calculate diluted earnings per share	$1,000 + 30 = 1,030$
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Diluted earnings per share	$\frac{1,010}{1,030} = 0.98$
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³ This example does not illustrate the classification of convertible financial instruments between liabilities and equity or the classification of related interest and dividends between expenses and equity as required by IAS 32.

Example 5 - Determining the Order in Which to Include Dilutive Securities in the Calculation of Weighted Average Number of Shares⁴

Earnings

Profit from continuing operations	16,400,000
Less dividends on preference shares	<u>(6,400,000)</u>
Profit from continuing operations attributable to ordinary shareholders	10,000,000
Loss from discontinuing operations	<u>(3,000,000)</u>
Net profit attributable to ordinary shareholders	<u>7,000,000</u>
Ordinary shares outstanding	2,000,000
Average market price of one ordinary share during year	75.00

Potential Ordinary Shares

Options	100,000 with exercise price of 60
Convertible preference shares	800,000 shares entitled to a cumulative dividend of 8 per share. Each preference share is convertible to 2 ordinary shares.
5% convertible bonds	Nominal amount 100,000,000. Each 1,000 bond is convertible to 20 ordinary shares. There is no amortisation of premium or discount affecting the determination of interest expense.
Tax rate	40%

⁴ This example does not illustrate the classification of convertible financial instruments between liabilities and equity or the classification of related interest and dividends between expenses and equity as required by IAS 32.

Increase in Earnings Attributable to Ordinary Shareholders on Conversion of Potential Ordinary Shares

		<i>Increase in earnings</i>	<i>Increase in number of ordinary shares</i>	<i>Earnings per incremental share</i>
<i>Options</i>				
Increase in earnings		Nil		
Incremental shares issued for no consideration	100,000 x (75-60)/75		20,000	Nil
<i>Convertible preference shares</i>				
Increase in profit	8 x 800,000	6,400,000		
Incremental shares	2 x 800,000		1,600,000	4.00
<i>5% convertible bonds</i>				
Increase in profit	100,000,000 x 0.05 x (1 - 0.40)	3,000,000		
Incremental shares	100,000 x 20		2,000,000	1.50

Calculation of Diluted Earnings Per Share

	<i>Profit from continuing operations attributable to ordinary shareholders (control number)</i>	<i>Ordinary shares</i>	<i>Per share</i>	
As reported	10,000,000	2,000,000	5.00	
Options	--	20,000		
	10,000,000	2,020,000	4.95	Dilutive
5% convertible bonds	3,000,000	2,000,000		
	13,000,000	4,020,000	3.23	Dilutive
Convertible preference shares	6,400,000	1,600,000		
	19,400,000	5,620,000	3.45	Anti-dilutive

Since diluted earnings per share is increased when taking the convertible preference shares into account (from 3.23 to 3.45), the convertible preference shares are anti-dilutive and are ignored in the calculation of diluted earnings per share. Therefore, diluted earnings per share for profit from continuing operations is 3.23:

	<i>Basic EPS</i>	<i>Diluted EPS</i>
Profit from continuing operations	5.00	3.23
Loss from discontinuing operations	(1.50) ^(a)	(0.75) ^(b)
Net profit	3.50 ^(c)	2.48 ^(d)

^(a) $(3,000,000)/2,000,000 = (1.50)$

^(b) $(3,000,000)/4,020,000 = (0.75)$

^(c) $7,000,000/2,000,000 = 3.50$

^(d) $(7,000,000+3,000,000)/4,020,000 = 2.48$

Example 6 - Effects of Share Options on Diluted Earnings Per Share

Net profit for year 20X1	1,200,000
Weighted average number of ordinary shares outstanding during year 20X1	500,000 shares
Average market price of one ordinary share during year 20X1	20.00
Weighted average number of shares under option during year 20X1	100,000 shares
Exercise price for shares under option during year 20X1	15.00

Calculation of earnings per share

	<i>Per share</i>	<i>Earnings</i>	<i>Shares</i>
Net profit for year 20X1		1,200,000	
Weighted average shares outstanding during year 20X1			500,000
Basic earnings per share	2.40		
Weighted average number of shares under option			100,000
Weighted average number of shares that would have been issued at average market price: (100,000 x 15.00) / 20.00		(a)	(75,000)
Diluted earnings per share	2.29	1,200,000	525,000

- (a) Earnings have not been increased as the total number of shares has been increased only by the number of shares (25,000) deemed for the purpose of the calculation to have been issued for no consideration (see paragraph 42(b))

Example 7 - Contingently Issuable Shares⁵

Ordinary shares outstanding during 20X1 1,000,000 (there were no options, warrants or convertible securities outstanding during the period)

The terms of an agreement related to a recent business combination provide for the issue of additional ordinary shares based on the following conditions:

5,000 additional ordinary shares for each new retail site opened during 20X1

1,000 additional ordinary shares for each 1,000 of consolidated, after-tax net profit in excess of 2,000,000 for the year ended 31 December 20X1

Retail sites opened during the year:

one on 1 May 20X1

one on 1 September 20X1

Consolidated year-to-date after-tax net profit:

1,100,000 as of 31 March 20X1

2,300,000 as of 30 June 20X1

1,900,000 as of 30 September 20X1 (including a 450,000 loss from a discontinuing operation)

2,900,000 as of 31 December 20X1

⁵ For the calculation of diluted earnings per share for an interim period, contingent shares are included as of the beginning of the period. For year-to-date calculations, contingent shares are included on a weighted average basis.

Basic earnings per share

	<i>First quarter</i>	<i>Second quarter</i>	<i>Third quarter</i>	<i>Fourth quarter</i>	<i>Full year</i>
Numerator	1,100,000	1,200,000	(400,000)	1,000,000	2,900,000
Denominator:					
Ordinary shares outstanding	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Retail site contingency	--	3,333 ^(a)	6,667 ^(b)	10,000	5,000 ^(c)
Earnings contingency ^(d)	--	--	--	--	--
Total shares	<u>1,000,000</u>	<u>1,003,333</u>	<u>1,006,667</u>	<u>1,010,000</u>	<u>1,005,000</u>
Basic earnings per share	<u>1.10</u>	<u>1.20</u>	<u>(0.40)</u>	<u>0.99</u>	<u>2.89</u>

^(a) 5,000 shares \times 2/3

^(b) 5,000 shares + (5,000 shares \times 1/3)

^(c) (5,000 shares \times 8/12) + (5,000 shares \times 4/12)

^(d) The earnings contingency has no effect on basic earnings per share because it is not certain that the condition is satisfied until the end of the contingency period. The effect is negligible for the fourth-quarter and full-year calculations because it is not certain that the condition is met until the last day of the period.

Diluted earnings per share

	<i>First quarter</i>	<i>Second quarter</i>	<i>Third quarter</i>	<i>Fourth quarter</i>	<i>Full year</i>
Numerator	1,100,000	1,200,000	(400,000)	1,000,000	2,900,000
Denominator:					
Ordinary shares outstanding	1,000,000	1,000,000	1,000,000	1,000,000	1,000,000
Retail site contingency	--	5,000	10,000	10,000	6,250 ^(e)
Earnings contingency	-- ^(f)	300,000 ^(g)	-- ^(h)	900,000 ⁽ⁱ⁾	300,000 ^(j)
Total shares	<u>1,000,000</u>	<u>1,305,000</u>	<u>1,010,000</u>	<u>1,910,000</u>	<u>1,306,250</u>
Diluted earnings per share	<u>1.10</u>	<u>0.92</u>	<u>(0.40)^(k)</u>	<u>0.52</u>	<u>2.22</u>

^(e) $(0 + 5,000 + 10,000 + 10,000) \div 4$

^(f) Company A did not have 2,000,000 year-to-date, after-tax net profit at 31 March 20X1. Projecting future earnings levels and including the related contingent shares are not permitted by this standard.

^(g) $[(2,300,000 - 2,000,000) \div 1,000] \times 1,000$ shares.

^(h) Year-to-date, after-tax net profit was less than 2,000,000.

⁽ⁱ⁾ $[(2,900,000 - 2,000,000) \div 1,000] \times 1,000$ shares.

^(j) $(0 + 300,000 + 0 + 900,000) \div 4$.

^(k) Because the loss during the third quarter is due to a loss from a discontinuing operation, the anti-dilution rules do not apply (control number is positive, ie profit or loss from continuing operations).

Example 8 – Convertible Bonds that may be Settled in Shares or Cash at the Issuer’s Option

An entity issues 2,000 convertible bonds at the beginning of Year 1. The bonds have a three-year term, and are issued at par with a face value of 1,000 per bond, giving total proceeds of 2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 per cent. Each bond is convertible at any time up to maturity into 250 common shares. The entity has an option to settle the principal amount of the convertible bonds in ordinary shares or in cash.

When the bonds are issued, the prevailing market interest rate for similar debt without a conversion option is 9 per cent. At the issue date, the market price of one common share is 3. Income tax is ignored.

Net profit Year 1	1,000,000
Ordinary shares outstanding	1,200,000
Convertible bonds outstanding	2,000
Liability component	1,848,122 ⁶
Equity component	<u>151,878</u>
Proceeds of the bond issue	<u><u>2,000,000</u></u>

The liability and equity components would be determined in accordance with IAS 32, Financial Instruments: Disclosure and Presentation. These amounts would be recognised as the initial carrying amounts of the liability and equity components presented on the balance sheet. The amount assigned to the issuer conversion option equity element is a permanent addition to equity and is not adjusted.

Basic earnings per share Year 1:

$$\frac{1,000,000}{1,200,000} = 0.83 \text{ per ordinary share}$$

⁶ Present value of the principal and interest discounted at 9% - 2,000,000 payable at the end of three years; 120,000 payable annually in arrears for three years.

Diluted earnings per share Year 1:

1. If it is presumed that the issuer will settle the contract by the issue of ordinary shares, the dilutive effect would be calculated in accordance with paragraph 51(b).

$$\frac{1,000,000 + 166,331^{(a)}}{1,200,000 + 500,000^{(b)}} = 0.69 \text{ per ordinary share}$$

(a) The initial carrying amount is adjusted for the accretion of 166,331 (1,848,122 x 9%) of the liability due to the time value of money.

(b) 500,000 ordinary shares =
250 ordinary shares x 2000 convertible bonds

2. If past practice or stated policy provides a reasonable basis to believe the issuer would settle in cash, the effect on diluted earnings per share of cash settlement would be as follows:

$$\frac{1,000,000 + 166,331 - 120,000^{(c)}}{1,200,000} = 0.87 \text{ per ordinary share}$$

(c) Paragraph 51(c) requires that the numerator be adjusted for any changes in profit or loss that would have resulted if the convertible bonds had been classified wholly as a liability. In this example, the liability would be 2,000,000. The effective yield on the security is decreased from 9% to 6% producing interest expense in Year 1 of 2,000,000 x 6% = 120,000.

The resulting diluted earnings per share is anti-dilutive and, therefore, will not be reported in the financial statements.

Example 9 - Rights Issue

	<u>20X0</u>	<u>20X1</u>	<u>20X2</u>
Net profit	1,100	1,500	1,800
Shares outstanding before rights issue		500 shares	
Rights issue		One new share for each five outstanding share (100 new shares total)	
		Exercise price: 5.00	
		Date of rights issue: 1 January 20X1	
		Late date to exercise rights: 1 March 20X1	
Market price of one ordinary share immediately before exercise on 1 March 20X1:	11.00		

Calculation of theoretical ex-rights value per share

$$\frac{\text{Fair value of all outstanding shares before the exercise of rights} + \text{total amount received from exercise of rights}}{\text{Number of shares outstanding before exercise} + \text{number of shares issued in the exercise}}$$

$$\frac{(11.00 \times 500 \text{ shares}) + (5.00 \times 100 \text{ shares})}{500 \text{ shares} + 100 \text{ shares}}$$

Theoretical ex-rights value per share = 10.00

Calculation of adjustment factor

$$\frac{\text{Fair value per share before exercise of rights}}{\text{Theoretical ex-rights value per share}} = \frac{11.00}{10.00} = 1.10$$

Calculation of earnings per share

		<u>20X0</u>	<u>20X1</u>	<u>20X2</u>
20X0 EPS as originally reported:	1,100/500 shares	2.20		
20X0 EPS restated for rights issue:	<u>1,100</u> (500 shares x 1.1)	<u>2.00</u>		
20X1 EPS including effects of rights issue:	<u>1,500</u> (500 x 1.1 x 2/12) + (600 x 10/12)		<u>2.54</u>	
20X2 EPS:	1,800/ 600 shares			<u>3.00</u>

Example 10 - Securities of a Subsidiary: Calculation of Basic and Diluted Earnings Per Share⁷

Parent:

Net profit	12,000 (excluding any earnings of, or dividends paid by, the subsidiary)
Ordinary shares outstanding	10,000
Securities of subsidiary owned by the parent	800 ordinary shares 30 warrants exercisable to purchase ordinary shares of subsidiary 300 convertible preference shares

Subsidiary:

Net profit	5,400
Ordinary shares outstanding	1,000
Warrants	150, exercisable to purchase ordinary shares of the subsidiary
Exercise price	10
Average market price of one ordinary share	20
Preference shares	400, each convertible into one ordinary share
Dividends on preference shares	1 per share

No inter-company eliminations or adjustments were necessary except for dividends.

For the purposes of this illustration, income taxes have been ignored.

⁷ This example does not illustrate the classification of convertible financial instruments between liabilities and equity or the classification of related interest and dividends between expenses and equity as required by IAS 32.

Subsidiary's earnings per share

Basic EPS	5.00	calculated:	$\frac{5,400^{(a)} - 400^{(b)}}{1,000^{(c)}}$
Diluted EPS	3.66	calculated:	$\frac{5,400^{(d)}}{(1,000 + 75^{(e)} + 400^{(f)})}$

- (a) Subsidiary's net profit.
- (b) Dividends paid by subsidiary on convertible preference shares.
- (c) Subsidiary's ordinary shares outstanding.
- (d) Subsidiary's profit attributable to ordinary shareholders (5,000) increased by 400 preference dividends for the purpose of calculating diluted earnings per share.
- (e) Incremental shares from warrants, calculated: $[(20 - 10) \div 20] \times 150$.
- (f) Subsidiary's ordinary shares assumed outstanding from conversion of convertible preference shares, calculated: 400 convertible preference shares \times conversion factor of 1.

Consolidated earnings per share

Basic EPS	1.63	calculated:	$\frac{12,000^{(g)} + 4,300^{(h)}}{10,000^{(i)}}$
Diluted EPS	1,61	calculated:	$\frac{12,000 + 2,928^{(j)} + 55^{(k)} + 1,098^{(l)}}{10,000}$

- (g) Parent's net profit.
- (h) Portion of subsidiary's profit to be included in consolidated basic earnings per share, calculated: $(800 \times 5.00) + (300 \times 1.00)$.
- (i) Parent's ordinary shares outstanding.
- (j) Parent's proportionate interest in subsidiary's earnings attributable to ordinary shares, calculated: $(800 \div 1,000) \times (1,000 \text{ shares} \times 3.66 \text{ per share})$.
- (k) Parent's proportionate interest in subsidiary's earnings attributable to warrants, calculated: $(30 \div 150) \times (75 \text{ incremental shares} \times 3.66 \text{ per share})$.
- (l) Parent's proportionate interest in subsidiary's earnings attributable to convertible preference shares, calculated: $(300 \div 400) \times (400 \text{ shares from conversion} \times 3.66 \text{ per share})$.

Example 11 - Participating Securities and Two-Class Ordinary Shares⁸

Net profit	100,000
Ordinary shares outstanding	10,000
Non-convertible preference shares	6,000
Non-cumulative annual dividend on preference shares (before any dividend is paid on ordinary shares)	5.50 per share

After ordinary shares have been paid a dividend of 2.10 per share, the preference shares then participate in any additional dividends on a 20:80 ratio with ordinary shares (ie after preference and ordinary shares have been paid dividends of 5.50 and 2.10 per share, respectively, preference shares participate in any additional dividends at a rate of one-fourth of the additional amount paid to ordinary shares on a per-share basis).

Dividends on preference shares paid	33,000	(5.50 per share)
Dividends on ordinary shares paid	21,000	(2.10 per share)

⁸ This example does not illustrate the classification of convertible financial instruments between liabilities and equity or the classification of related interest and dividends between expenses and equity as required by IAS 32.

Basic earnings per share is calculated as follows:

Net profit		100,000
Less dividends paid:		
Preference	33,000	
Ordinary	21,000	<u>(54,000)</u>
Undistributed earnings		<u><u>46,000</u></u>

Allocation of undistributed earnings:

Allocation per ordinary share = A

Allocation per preference share = B; B = 1/4 A

$$(A \times 10,000) + (1/4 \times A \times 6,000) = 46,000$$

$$A = 46,000 / (10,000 + 1,500)$$

$$A = 4.00$$

$$B = 1/4 A$$

$$B = 1.00$$

Basic per share amounts:

	<i>Preference shares</i>	<i>Ordinary shares</i>
Distributed earnings	5.50	2.10
Undistributed earnings	1.00	4.00
Totals	<u>6.50</u>	<u>6.10</u>

Example 12 - Calculation of Basic and Diluted Earnings Per Share and Income Statement Presentation (Comprehensive Example)⁹

This example illustrates the quarterly and annual calculations of basic and diluted earnings per share in the year 20X1 for Company A, which has a complex capital structure. The control number is profit or loss from continuing operations. Other facts assumed are as follows:

Average market price of ordinary shares: The average market prices of ordinary shares for the calendar year 20X1 were as follows:

First quarter	49
Second quarter	60
Third quarter	67
Fourth quarter	67

The average market price of ordinary shares from 1 July to 1 September 20X1 was 65.

Ordinary shares: The number of ordinary shares outstanding at the beginning of 20X1 was 5,000,000. On 1 March 20X1, 200,000 ordinary shares were issued for cash.

Convertible bonds: In the last quarter of 20X0, 5 per cent convertible bonds with a principal amount of 12,000,000 due in 20 years were sold for cash at 1,000 (par). Interest is payable semi-annually on 1 November and 1 May. Each 1,000 bond is convertible into 40 ordinary shares. No bonds were converted in 20X0. The entire issue was converted on 1 April 20X1 because the issue was called by Company A.

Convertible preference shares: In the second quarter of 20X0, 800,000 shares of convertible preference shares were issued for assets in a purchase transaction. The quarterly dividend on each convertible preference share is 0.05, payable at the end of the quarter. Each share is convertible into one ordinary share. Holders of 600,000 convertible preference shares converted their preference shares into ordinary shares on 1 June 20X1.

Warrants: Warrants to buy 600,000 ordinary shares at 55 per share for a period of five years were issued on 1 January 20X1. All outstanding warrants were exercised on 1 September 20X1.

Options: Options to buy 1,500,000 ordinary shares at 75 per share for a period of 10 years were issued on 1 July 20X1. No options were exercised during 20X1 because the exercise price of the options exceeded the market price of the ordinary shares.

⁹ This example does not illustrate the classification of convertible financial instruments between liabilities and equity or the classification of related interest and dividends between expenses and equity as required by IAS 32.

Tax rate: The tax rate was 40 per cent for 20X1.

20X1	<i>Profit (loss) from continuing operations^(a)</i>	<i>Net profit (loss)</i>
First quarter	5,000,000	5,000,000
Second quarter	6,500,000	6,500,000
Third quarter	1,000,000	(1,000,000) ^{b)}
Fourth quarter	<u>(700,000)</u>	<u>(700,000)</u>
Full year	<u>11,800,000</u>	<u>9,800,000</u>

First Quarter 20X1

Basic EPS calculation

Profit from continuing operations	5,000,000
Less: preference shares dividends	<u>(40,000) ^(c)</u>
Profit attributable to ordinary shareholders	<u>4,960,000</u>

<i>Dates Outstanding</i>	<i>Shares Outstanding</i>	<i>Fraction of period</i>	<i>Weighted- average shares</i>
1 January - 28 February	5,000,000	2/3	3,333,333
<i>Issue of ordinary shares on 1 March</i>	<u>200,000</u>		
1 March - 31 March	5,200,000	1/3	<u>1,733,333</u>
Weighted-average shares			<u>5,066,666</u>

Basic EPS **0.98**

^(a) This is the control number (before adjusting for preference dividends).

^(b) Company A had a 2 million loss (net of tax) from discontinuing operations in the third quarter.

^(c) 800,000 shares x 0.05

Diluted EPS calculation

Profit attributable to ordinary shareholders		4,960,000
Plus: profit impact of assumed conversions		
Preference share dividends	40,000	(d)
Interest on 5% convertible bonds	<u>90,000</u>	(e)
Effect of assumed conversions		<u>130,000</u>
Profit attributable to ordinary shareholders including assumed conversions		<u>5,090,000</u>
 Weighted-average shares		 5,066,666
Plus: incremental shares from assumed conversions		
Warrants	0	(f)
Convertible preference shares	800,000	
5% convertible bonds	<u>480,000</u>	
Dilutive potential ordinary shares		<u>1,280,000</u>
Adjusted weighted-average shares		<u><u>6,346,666</u></u>
 <i>Diluted EPS</i>		 <u><u>0.80</u></u>

(d) 800,000 shares x 0.05

(e) (12,000,000 x 5%) / 4; less taxes at 40%

(f) The warrants were not assumed to be exercised because they were anti-dilutive in the period (55 [exercise price] > 49 [average price]).

Second Quarter 20X1*Basic EPS calculation*

Profit from continuing operations	6,500,000
Less: preference shares dividends	(10,000) ^(g)
Profit attributable to ordinary shareholders	<u>6,490,000</u>

<i>Dates outstanding</i>	<i>Shares outstanding</i>	<i>Fraction of period</i>	<i>Weighted-average shares</i>
1 April	5,200,000		
<i>Conversion of 5% bonds on 1 April</i>	<u>480,000</u>		
1 April-31 May	5,680,000	2/3	3,786,666
<i>Conversion of preference shares on 1 June</i>	<u>600,000</u>		
1 June-30 June	6,280,000	1/3	<u>2,093,333</u>
Weighted-average shares			<u><u>5,880,000</u></u>

*Basic EPS***1.10**^(g) 200,000 shares x 0.05

Diluted EPS calculation

Profit attributable to ordinary shareholders		6,490,000
Plus: profit impact of assumed conversions		
Preference share dividends	<u>10,000</u> ^(h)	
Effect of assumed conversions		<u>10,000</u>
Profit attributable to ordinary shareholders including assumed conversions		<u>6,500,000</u>
 Weighted-average shares		 5,880,000
Plus: incremental shares from assumed conversions		
Warrants	50,000 ⁽ⁱ⁾	
Convertible preference shares	<u>600,000</u> ^(j)	
Dilutive potential ordinary shares		<u>650,000</u>
Adjusted weighted-average shares		<u>6,530,000</u>
 Diluted EPS		 <u><u>1.00</u></u>

^(h) 200,000 shares x 0.05

⁽ⁱ⁾ $55 \times 600,000 = 33,000,000$; $33,000,000 / 60 = 550,000$; $600,000 - 550,000 = 50,000$ shares OR $[(60 - 55) / 60] \times 600,000$ shares = 50,000 shares

^(j) $(800,000 \text{ shares} \times 2/3) + (200,000 \text{ shares} \times 1/3)$

Third Quarter 20X1*Basic EPS calculation*

Profit from continuing operations	1,000,000
Less: preference shares dividends	<u>(10,000)</u>
Profit attributable to ordinary shareholders	990,000
Loss from discontinuing operation	<u>(2,000,000)</u>
Net loss attributable to ordinary shareholders	<u><u>(1,010,000)</u></u>

<i>Dates outstanding</i>	<i>Shares outstanding</i>	<i>Fraction of period</i>	<i>Weighted- average shares</i>
1 July	6,280,000	2/3	4,186,666
<i>Exercise of warrants on 1 September</i>	<u>600,000</u>		
1 July –30 September	6,880,000	1/3	<u>2,293,333</u>
Weighted-average shares			<u><u>6,480,000</u></u>

Basic EPS

Profit from continuing operations	0.15
Loss from discontinuing operations	<u>(0.31)</u>
Net loss	<u><u>(0.16)</u></u>

Diluted EPS calculation

Profit attributable to ordinary shareholders		990,000
Plus: profit impact of assumed conversions		
Preference share dividends	<u>10,000</u>	
Effect of assumed conversions		<u>10,000</u>
Profit attributable to ordinary shareholders including assumed conversions		1,000,000
Loss from discontinuing operations		<u>(2,000,000)</u>
Net loss attributable to ordinary shareholders including assumed conversions		<u><u>(1,000,000)</u></u>
 Weighted-average shares		 6,480,000
Plus: incremental shares from assumed conversions		
Warrants	61,538 ^{k)}	
Convertible preference shares	<u>200,000</u>	
Dilutive potential ordinary shares		<u>261,538</u>
Adjusted weighted-average shares		<u><u>6,741,538</u></u>

Diluted EPS

Profit from continuing operations		<i>0.15</i>
Loss from discontinuing operations		<u><i>(0.30)</i></u>
Net loss		<u><u><i>(0.15)</i></u></u>

^(k) $[(65 - 55) / 65] \times 600,000 = 92,308$ shares; $92,308 \times 2/3 = 61,538$ shares

Note: The incremental shares from assumed conversions are included in calculating the diluted per-share amounts for the loss from discontinuing operations and loss even though they are anti-dilutive. This is because the control number (profit from continuing operations, adjusted for preference dividends) was positive (ie profit, rather than loss).

Fourth Quarter 20X1*Basic and diluted EPS
calculation*

Loss from continuing operations	(700,000)
Add: preference shares dividends	<u>(10,000)</u>
Net loss attributable to ordinary shareholders	<u><u>(710,000)</u></u>

<i>Dates outstanding</i>	<i>Shares outstanding</i>	<i>Fraction of period</i>	<i>Weighted- average shares</i>
1 October –31 December	6,880,000	3/3	<u>6,880,000</u>
Weighted-average shares			<u><u>6,880,000</u></u>

Basic and diluted EPS

Loss attributable to ordinary shareholders	<u><u>(0.10)</u></u>
--	-----------------------------

Note: The incremental shares from assumed conversions are not included in calculating the diluted per-share amounts because the control number (loss attributable to ordinary shareholder adjusted for preference dividends) was negative (ie a loss, rather than profit).

Full year 20X1

Basic EPS calculation

Profit from continuing operations	11,800,000
Less: preference shares dividends	<u>(70,000)</u>
Profit attributable to ordinary shareholders	11,730,000
Loss from discontinuing operations	<u>(2,000,000)</u>
Net profit attributable to ordinary shareholders	<u><u>9,730,000</u></u>

<i>Dates Outstanding</i>	<i>Shares Outstanding</i>	<i>Fraction of period</i>	<i>Weighted-average shares</i>
1 January - 28 February	5,000,000	2/12	833,333
<i>Issue of ordinary shares on 1 March</i>	<u>200,000</u>		
1 March - 31 March	5,200,000	1/12	433,333
<i>Conversion of 5% bonds on 1 April</i>	<u>480,000</u>		
1 April - 31 May	5,680,000	2/12	946,667
<i>Conversion of preference shares on 1 June</i>	<u>600,000</u>		
1 June - 30 June	6,280,000	3/12	1,570,000
<i>Exercise of warrants on 1 September</i>	<u>600,000</u>		
1 July - 30 September	6,880,000	4/12	<u>2,293,333</u>
Weighted-average shares			<u><u>6,076,667</u></u>

Basic EPS

Profit from continuing operations	1.93
Loss from discontinuing operations	<u>(0.33)</u>
Net profit	<u><u>1.60</u></u>

Diluted EPS calculation

Profit attributable to ordinary shareholders		11,730,000
Plus: profit impact of assumed conversions		
Preference share dividends	70,000	
Interest on 5% convertible bonds	<u>90,000</u>	
Effect of assumed conversions		<u>160,000</u>
Profit attributable to ordinary shareholders including assumed conversions		11,890,000
Loss from discontinuing operations		<u>(2,000,000)</u>
Net profit attributable to ordinary shareholders including assumed conversions		<u><u>9,890,000</u></u>
 Weighted-average shares		 6,076,667
Plus: incremental shares from assumed conversions		
Warrants	27,884 ⁽¹⁾	
Convertible preference shares	450,000 ^(m)	
5% convertible bonds	<u>120,000 ⁽ⁿ⁾</u>	
Dilutive potential ordinary shares		<u>597,884</u>
Adjusted weighted-average shares		<u><u>6,674,551</u></u>

Diluted EPS

Profit from continuing operations		1.78
Loss from discontinuing operations		<u>(0.30)</u>
Net profit		<u><u>1.48</u></u>

⁽¹⁾ (50,000 shares x 3/12) + (61,538 shares x 3/12)

^(m) (800,000 shares x 5/12) + (200,000 shares x 7/12)

⁽ⁿ⁾ 480,000 shares x 3/12

The following illustrates how Company A might present its earnings per share data on its income statement. Note that the amounts per share for the loss from discontinuing operations is not required to be shown on the face of the income statement.

*For the year
ended 20X1*

Earnings per ordinary share

Profit from continuing operations	1.93
Loss from discontinuing operations	<u>(0.33)</u>
Net profit	<u>1.60</u>

Diluted earnings per ordinary share

Profit from continuing operations	1.78
Loss from discontinuing operations	<u>(0.30)</u>
Net profit	<u>1.48</u>

The following table includes the quarterly and annual earnings per share data for Company A. The purpose of this table is to illustrate that the sum of the four quarters' earnings per share data will not necessarily equal the annual earnings per share data. The Standard does not require disclosure of this information.

	<i>First quarter</i>	<i>Second quarter</i>	<i>Third quarter</i>	<i>Fourth quarter</i>	<i>Full year</i>
Basic EPS					
Profit (loss) from continuing operations	0.98	1.10	0.15	(0.10)	1.93
Loss from discontinuing operations	--	--	(0.31)	--	(0.33)
Net profit (loss)	<u>0.98</u>	<u>1.10</u>	<u>(0.16)</u>	<u>(0.10)</u>	<u>1.60</u>
Diluted EPS					
Profit (loss) from continuing operations	0.80	1.00	0.15	(0.10)	1.78
Loss from discontinuing operations	--	--	(0.30)	--	(0.30)
Net profit (loss)	<u>0.80</u>	<u>1.00</u>	<u>(0.15)</u>	<u>(0.10)</u>	<u>1.48</u>

Appendix C

Basis for Conclusions (Revisions 200X)

- C1. This Basis for Conclusions summarises the Board's considerations in reaching the conclusions in this Exposure Draft. Individual Board members gave greater weight to some factors than to others.
- C2. In July 2001 the Board announced that, as part of its initial agenda of technical projects, it would undertake a project to improve a number of standards, including IAS 33. The Board's objectives in the Improvements project are to reduce or eliminate alternatives, redundancies and conflicts within existing Standards, to deal with some convergence issues and to make other improvements. As the intention of the Improvements project is not to reconsider the fundamental principles for the determination of earnings per share established by IAS 33, this Basis for Conclusions does not discuss requirements in IAS 33 that the Board has not reconsidered.

Contracts that may be settled in shares or in cash

- C3. Paragraph 4 of IAS 33 defines potential ordinary shares as financial instruments or other contracts that may entitle its holder to ordinary shares. The consensus in SIC-24, Earnings per Share - Financial Instruments and Other Contracts That May Be Settled in Shares, indicates that if it is possible that the holder will receive ordinary shares, regardless of the probability of that occurring, the contract is a potential ordinary share. As such it is considered in calculating diluted earnings per share.
- C4. In the corresponding standards of some liaison standard-setters, potential ordinary shares are included in the diluted earnings per share calculation based on a rebuttable presumption that if the issuer has the ability to settle the contract in ordinary shares, the issuer would use that right. This presumption can be rebutted if the issuer has acted through an established pattern of past practice, published policies, or by making a sufficiently specific current statement indicating to other parties the manner in which it expects to settle, and, as a result, the issuer has created a valid expectation on the part of those other parties that it will settle in a manner other than by issuing shares. Giving effect to all potential dilutive shares without

regard to other factors and relevant historical information is inconsistent with the objective of the diluted earnings per share disclosure.

- C5. For the reasons given in the previous paragraph, the Board decided to propose the latter approach. SIC-24 would be withdrawn if this approach were included in the revised Standard.

Other changes

- C6. Implementation questions have arisen in various jurisdictions since the issuance of IAS 33, typically concerning the application of the Standard to complex capital structures and arrangements. In response, the Board is proposing additional guidance and illustrative examples on many of the more complex matters, such as the effects of contingently issuable shares; potential ordinary shares of subsidiaries, joint ventures or associates; participating securities; written put options; and purchased put and call options that were not addressed in IAS 33.

Proposed Improvements to International Accounting Standard IAS 40

Investment Property

International Accounting Standard IAS 40 (revised 200X)

Investment Property

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

Invitation to Comment

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

Question 1

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

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

Question 2

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

Question 3

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

Summary of Main Changes

The main changes proposed are:

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

Contents

Limited revisions to International Accounting Standard IAS 40 Investment Property

[Marked-up text]

SCOPE	Paragraph 2
DEFINITIONS	4
	[Paragraph deleted] 13
MEASUREMENT SUBSEQUENT TO INITIAL RECOGNITION	
Fair Value Model	26A
EFFECTIVE DATE	74A
<u>APPENDIX:</u> <u>Basis for Conclusions (Revisions 200X)</u>	

Limited revisions to International Accounting Standard IAS 40 Investment Property

[Marked-up text]

Scope

[amend paragraph 2]

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

Definitions

[amend paragraph 4 and delete paragraph 13]

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

Investment property is property (land or a building – or part of a building – or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

- (a) *use in the production or supply of goods or services or for administrative purposes; or*
- (b) *sale in the ordinary course of business.*

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

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

Measurement Subsequent to Initial Recognition

Fair Value Model

[add new paragraph 26A]

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

Effective Date

[add new paragraph 74A]

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

Appendix

Basis for Conclusions (Revisions 200X)

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

Property interests held under an operating lease

- A3. Paragraph 11 of IAS 17, Leases, requires a lease of land with an indefinite economic life to be classified as an operating lease, unless title is expected to pass to the lessee by the end of the lease term. This operating lease classification prevents the lessee from classifying its interest in the leased asset as an investment property under IAS 40. As a result, the lessee may not revalue its interest in the leased asset to fair value and report any change in fair value in net profit or loss. However, in some countries, interests in property (including land) are commonly ~~or~~ exclusively held under long-term leases. The effect of some of these leases differs very little from buying a property outright. As a result, some contend that such leases should be accounted for as finance leases and/or investment property.
- A4. The Board discussed a number of possible solutions to this issue. In particular, it considered deleting paragraph 11 of IAS 17, so that a long-term lease of land would be classified as a finance lease (and hence could qualify as an investment property) when the conditions

for finance lease classification in paragraphs 3-10 of IAS 17 are met. The Board noted, however, that this would not resolve all cases encountered in practice. Some leasehold interests held for investment would remain classified as operating leases (eg leases with significant contingent rents or upwards-only rent reviews), and hence could not be investment property under IAS 40.

- A5. In light of this, the Board decided to amend IAS 40's definition of investment property so that a lessee's interest in property that arises under an operating lease could qualify as investment property. The Board decided to limit this amendment to entities that use the fair value model in IAS 40, because the objective of the amendment is to permit use of the fair value model for property interests held under an operating lease. Put another way, a lessee that uses the cost model for investment property would not be permitted to capitalise operating leases. The Board also decided to make the proposed change optional, ie to propose that a lessee that has an interest in property under an operating lease be allowed, but not required, to classify that property interest as investment property (provided the rest of the definition of investment property is met), on a property-by-property basis.
- A6. Finally, the Board decided to propose that when a lessee's interest in property held under an operating lease is accounted for as an investment property, the lease is accounted for as if it were a finance lease. The Board noted that if the lease were accounted for as an operating lease, the asset recognised by the lessee at inception would be limited to the amount of any prepaid rentals. Hence the amount recognised as an asset would vary depending on the balance chosen between prepaid and ongoing rentals. Furthermore, if this asset were to be revalued by applying the fair value model in IAS 40, the change in fair value recognised in the income statement would similarly depend on the balance chosen between prepaid and ongoing rentals. To overcome this effect, the Board proposes that the full amount of the lessee's asset is recognised and revalued, regardless of the pattern of lease payments. This is achieved by accounting for the lease as if it were a finance lease.

The choice between the cost model and the fair value model

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

Proposed Consequential Amendments to International Accounting Standards and SIC Interpretations

Consequential Amendments to IASS and SIC Interpretations

The changes proposed in the preceding Exposure Drafts would, if made, lead to the consequential amendments to International Accounting Standards and SIC Interpretations set out below.

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

Amendments to IAS 7 (revised 1992), Cash Flow Statements

Paragraphs 25, 26, 29, 30 and 36 of IAS 7 are amended to read as follows:

25. *Cash flows arising from transactions in a foreign currency ~~should~~ shall be recorded in an enterprise's entity's reporting functional currency by applying to the foreign currency amount the exchange rate between the reporting functional currency and the foreign currency at the date of the cash flow.*
26. *The cash flows of a foreign subsidiary ~~should~~ shall be translated at the exchange rates between the reporting functional currency and the foreign currency at the dates of the cash flows.*
29. ~~[Deleted] The cash flows associated with extraordinary items should be classified as arising from operating, investing or financing activities as appropriate and separately disclosed.~~
30. ~~[Deleted] The cash flows associated with extraordinary items are disclosed separately as arising from operating, investing or financing activities in the cash flow statement, to enable users to understand their nature and effect on the present and future cash flows of the enterprise. These disclosures are in addition to the separate disclosures of the nature and amount of extraordinary items required by IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.~~
36. Taxes on income arise on transactions that give rise to cash flows that are classified as operating, investing or financing activities in a cash flow statement. Although ~~While~~ tax expense may be readily identifiable with investing or financing activities, the related tax cash flows ~~are often impracticable to~~ often cannot be identified without undue cost or effort identify and may arise in a different period from the cash flows of the underlying transactions. Therefore, taxes paid usually are classified as cash flows from operating activities. However, when ~~it is practicable to identify~~ the tax cash flow associated with an individual transaction that gives rise to cash flows that are classified as investing or financing activities can be identified without undue cost or effort, the tax cash flow is classified as an investing or financing activity as appropriate. When tax cash flows are allocated ~~to over~~ more than one class of activity, the total amount of taxes paid is disclosed.

Amendments to IAS 11 (revised 1993), Construction Contracts

Paragraph 38 of IAS 11 is amended to read as follows:

38. The percentage of completion method is applied on a cumulative basis in each accounting 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 IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors ~~Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies~~). The changed estimates are used in ~~the determination~~ of the amount of revenue and expenses recognised in the income statement in the period in which the change is made and in subsequent periods.

Amendments to IAS 12 (revised 2000), Income Taxes

Paragraphs 40, 41, 54, 62, 69, 77, 80, 81, 82A, 83, 87, 87B and 87C of IAS 12 are amended to read as follows:

40. ~~Because As~~ a parent controls the dividend policy of its subsidiary, the parent ~~it~~ is able to control the timing of the reversal of temporary differences associated with its that investments in that subsidiary (including the temporary differences arising not only from undistributed profits but also from any foreign exchange translation differences). Furthermore, it would often ~~be impracticable~~ require undue cost or effort to determine the amount of income taxes that would be payable when the temporary difference reverses. Therefore, when the parent has determined that those profits will not be distributed in the foreseeable future, the parent does not recognise a deferred tax liability. The same considerations apply to investments in branches.
41. ~~An enterprise accounts in its own currency for~~ The non-monetary assets and liabilities of an entity foreign operation are measured in its functional currency that is integral to the enterprise's operations (see IAS 21, The Effect of Changes in Foreign Exchange Rates). ~~Where~~ If the entity's foreign operation's taxable profit or tax loss (and, hence, the tax base of its non-monetary assets and liabilities) is determined in ~~the foreign~~ a different currency, changes in the exchange rate give rise to temporary differences. Because such temporary differences relate to the entity's foreign operation's own assets and liabilities, ~~rather than to the reporting enterprise's investments in that foreign operation, the reporting enterprise~~ they result in a recognised ~~the resulting~~ deferred tax liability or (subject to paragraph 24) asset. The resulting deferred tax is charged or credited in the income statement (see paragraph 58).
54. The reliable determination of deferred tax assets and liabilities on a discounted basis requires detailed scheduling of the timing of the reversal of each temporary difference. In many cases, such scheduling requires undue cost or effort ~~is impracticable~~ or is highly complex. Therefore, it is inappropriate to require discounting of deferred tax assets and liabilities. To permit, but not to require, discounting would result in deferred tax assets and liabilities that are ~~which would not be~~ comparable between entities ~~enterprises~~. Therefore, this Standard

does not require or permit the discounting of deferred tax assets and liabilities.

62. ~~International Accounting Standards require or permit certain particular items to be credited or charged directly to equity. Examples of such items are:~~

...

- (b) ~~an adjustment to the opening balance of retained earnings resulting from either a change in accounting policy that is applied retrospectively or the correction of a fundamental an error (see IAS 8, Accounting Policies, Changes in Accounting Estimates, and Errors Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies);~~

...

69. ~~*Tax assets and tax liabilities should be presented separately from other assets and liabilities in the balance sheet. Deferred tax assets and liabilities should shall be distinguished from current tax assets and liabilities.*~~

~~**Tax Expense (Income) related to Profit or Loss from Ordinary Activities**~~

77. ~~[Deleted] *The tax expense (income) related to profit or loss from ordinary activities should be presented on the face of the income statement.*~~

80. Components of tax expense (income) may include:

...

- (h) ~~[Deleted] the amount of tax expense (income) relating to those changes in accounting policies and fundamental errors which are included in the determination of net profit or loss for the period in accordance with the allowed alternative treatment in IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.~~

81. ~~*The following shall also be disclosed separately:*~~

- (a) ~~*the aggregate current and deferred tax relating to items that are charged or credited to equity;*~~

~~(b) tax expense (income) relating to extraordinary items recognised during the period;~~

~~(be) an explanation of the relationship between tax expense (income) and accounting profit or loss in either or both of the following forms:~~

...

~~(ik) in respect of discontinued operations, the tax expense relating to:~~

~~(i) the gain or loss on discontinuance; and~~

~~(ii) the profit or loss from the ordinary activities of the discontinued operation for the period, together with the corresponding amounts for each prior period presented.~~

...

82A. *In the circumstances described in paragraph 52A, an entity enterprise shall ~~should~~ disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the entity enterprise shall ~~should~~ disclose the amounts of the potential income tax consequences practicably ~~practicably~~ determinable without undue cost or effort and whether there are any potential income tax consequences ~~not practicably determinable~~ that cannot be determined without undue cost or effort.*

83. ~~[Deleted] An enterprise discloses the nature and amount of each extraordinary item either on the face of the income statement or in the notes to the financial statements. When this disclosure is made in the notes to the financial statements, the total amount of all extraordinary items is disclosed on the face of the income statement, net of the aggregate related tax expense (income). Although financial statement users may find the disclosure of the tax expense (income) related to each extraordinary item useful, it is sometimes difficult to allocate tax expense (income) between such items. Under these circumstances tax expense (income) relating to extraordinary items may be disclosed in the aggregate.~~

87. It would often require undue cost or effort ~~be impracticable~~ to compute the amount of unrecognised deferred tax liabilities arising from investments in subsidiaries, branches, and associates, and interest in

joint ventures (see paragraph 39). Therefore, this Standard requires an entity ~~enterprise~~ to disclose the aggregate amount of the underlying temporary differences, but does not require disclosure of the deferred tax liabilities. Nevertheless, ~~where practicable~~, enterprises ~~entities~~ are encouraged to disclose the amounts of the unrecognised deferred tax liabilities when this disclosure does not require undue cost or effort because financial statement users may find such information useful.

87B. It would sometimes require undue cost or effort ~~not be practicable~~ to compute the total amount of the potential income tax consequences that would result from the payment of dividends to shareholders. This may be the case, for example, where an entity ~~enterprise~~ has a large number of foreign subsidiaries. However, even in such circumstances, some portions of the total amount may be easily determinable. For example, in a consolidated group, a parent and some of its subsidiaries may have paid income taxes at a higher rate on undistributed profits and be aware of the amount that would be refunded on the payment of future dividends to shareholders from consolidated retained earnings. In this case, that refundable amount is disclosed. If applicable, the ~~enterprise~~ entity also discloses that there are additional potential income tax consequences ~~not practicably determinable~~ that cannot be determined without undue cost or effort. In the parent's separate financial statements, if any, the disclosure of the potential income tax consequences relates to the parent's retained earnings.

87C. An ~~enterprise~~ entity required to provide the disclosures in paragraph 82A may also be required to provide disclosures related to temporary differences associated with investments in subsidiaries, branches and associates or interest in joint ventures. In such cases, an entity ~~enterprise~~ considers this in determining the information to be disclosed under paragraph 82A. For example, an ~~enterprise~~ entity may be required to disclose the aggregate amount of temporary differences associated with investments in subsidiaries for which no deferred tax liabilities are ~~have been~~ recognised (see paragraph 81(f)). If it ~~is impracticable~~ requires undue cost or effort to compute the amounts of unrecognised deferred tax liabilities (see paragraph 87) there may be amounts of potential income tax consequences of dividends ~~not practicably determinable~~ related to these subsidiaries that cannot be determined without undue cost or effort.

Amendments to IAS 14 (revised 1997), Segment Reporting

Paragraphs 16, 43, 54, 60 and 76-79 of IAS 14 are amended to read as follows:

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

Segment revenue is revenue reported in the ~~enterprise's~~ entity's income statement that is directly attributable to a segment and the relevant portion of enterprise revenue that can be allocated on a reasonable basis to a segment, whether from sales to external customers or from transactions with other segments of the same enterprise. Segment revenue does not include:

(a) ~~extraordinary items;~~

(ab) interest or dividend income, including interest earned on advances or loans to other segments, unless the segment's operations are primarily of a financial nature; or

...

Segment expense is 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 sales to external customers and expenses relating to transactions with other segments of the same enterprise. Segment expense does not include:

(a) ~~extraordinary items;~~

(ab) interest, including interest incurred on advances or loans from other segments, unless the segment's operations are primarily of a financial nature;

...

43. *If a segment is identified as a reportable segment in the current period because it satisfies the relevant 10 per cent thresholds, prior period segment data ~~that is~~ presented for comparative purposes shall ~~should~~ be restated to reflect the newly reportable segment as a separate segment, even if that segment did not satisfy the 10 per cent*

thresholds in the prior period, unless ~~doing so requires undue cost or effort it is impracticable to do so.~~

54. An example of a measure of segment performance above segment result on the income statement is gross margin on sales. Examples of measures of segment performance below segment result on the income statement are profit or loss ~~from ordinary activities~~ (either before or after income taxes) and net profit or loss.
60. IAS ~~18~~ requires that ~~“The nature and amount of items of income or expense within profit or loss from ordinary activities that are of such size, nature, or incidence that their disclosure is relevant to an understanding of the entity’s financial performance of the enterprise for the period, the nature and amount of such items should~~ shall be disclosed separately”. IAS ~~18~~ offers a number of examples, including write-downs of inventories and property, plant, and equipment, provisions for restructurings, disposals of property, plant, and equipment and long-term investments, discontinuing discontinued operations, litigation settlements, and reversals of provisions. Paragraph 59 is not intended ~~to change the classification of any such items of revenue or expense from ordinary to extraordinary (as defined in IAS 8) 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 ~~enterprise~~ entity level to the segment level.
76. *Changes in accounting policies adopted for segment reporting that have a material effect on segment information ~~should~~ shall be disclosed, and prior period segment information presented for comparative purposes ~~should~~ shall be restated unless the restated information for a particular prior period cannot be obtained without undue cost or effort it is impracticable to do so. Such disclosure ~~should~~ 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 the restated information for a particular prior period cannot be obtained without undue cost or effort it is impracticable to do so, and the financial effect of the change, if it is reasonably determinable. If an enterprise entity changes the identification of its segments and it does not restate ~~prior period segment information for a particular prior period on the new basis because~~ the restated information for that prior period cannot be obtained without undue cost or effort it is impracticable to do so, then, for the purpose of comparison, the enterprise entity shall*

~~should report segment data for both the old and the new bases of segmentation in the year in which it changes the identification of its segments.~~

77. Changes in accounting policies adopted by the enterprise entity are dealt with in IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors. IAS 8 requires that changes in accounting policy ~~should~~ be made only if required by a Standard or an Interpretation of a Standard statute, or by an accounting standard-setting body, or if the change it will results in a more relevant and reliable appropriate presentation of events or transactions in the financial statements of the effects of transactions or other events on the entity's financial position, financial performance, or cash flows enterprise.
78. Changes in accounting policies adopted at the enterprise entity level that affect segment information are dealt with in ~~accordance with~~ IAS 8. Unless a new ~~International Accounting Standard~~ specifies otherwise, IAS 8 requires that a change in accounting policy ~~should~~ shall be applied retrospectively and that information for a particular prior period information be restated unless the restated information for that prior period cannot be obtained without undue cost or effort, it is impracticable to do so (benchmark treatment) or that the cumulative adjustment resulting from the change be included in determining the enterprise's net profit or loss for the current period (allowed alternative treatment). ~~If the benchmark treatment is followed, prior period segment information will be restated. If the allowed alternative is followed, the cumulative adjustment that is included in determining the enterprise's net profit or loss is included in segment result if it is an operating item that can be attributed or reasonably allocated to segments. In the latter case, IAS 8 may require separate disclosure if its size, nature, or incidence is such that the disclosure is relevant to explain the performance of the enterprise for the period.~~
79. 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 effect impact on the segment information reported but will do not change aggregate financial information reported for the enterprise 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 to reflect the new accounting policy, unless the

restated information for the prior period cannot be obtained without undue cost or effort if practicable.

Amendment to IAS 17 (revised 1997), Leases

Paragraph 12 of IAS 17 is amended to read as follows:

- 12. Lessees ~~should~~ shall recognise finance leases as assets and liabilities ~~in their balance sheets~~ at amounts equal at the inception of the lease to the fair value of the leased property or, if lower, at the present value of the minimum lease payments. In calculating the present value of the minimum lease payments the discount factor is the interest rate implicit in the lease, if this ~~is practicable to determine;~~ can be determined without undue cost or effort; if not, the lessee's incremental borrowing rate ~~is~~ should be used.*

Amendments to IAS 19 (revised 2000), Employee Benefits

Paragraphs 23, 99, 124, 131, 143, 148 and 151 of IAS 19 are amended to read as follows:

23. Although this Standard does not require specific disclosures about short-term employee benefits, other ~~International Accounting Standards~~ may require disclosures. ~~For example, where required by IAS 24, Related Party Disclosures, an enterprise discloses information about employee benefits for key management personnel.~~ IAS 1, Presentation of Financial Statements, requires that an entity enterprise ~~to should~~ disclose employee benefits expense ~~staff costs~~.
99. An ~~enterprise~~ entity establishes the amortisation schedule for past service cost when the benefits are introduced or changed. It would ~~be impracticable~~ require undue cost or effort to maintain the detailed records needed to identify and implement subsequent changes in that amortisation schedule. Moreover, the effect likely is ~~likely to be~~ material only where there is a curtailment or settlement. Therefore, an ~~enterprise~~ entity amends the amortisation schedule for past service cost only if there is a curtailment or settlement.
124. Where required by IAS 24, Related Party Disclosures, an entity enterprise discloses information about:
 - (a) related party transactions with post-employment benefit plans; ~~and~~
 - (b) ~~post-employment benefits for key management personnel.~~
131. Although this Standard does not require specific disclosures about other long-term employee benefits, other ~~International Accounting Standards~~ may require disclosures, for example where the expense resulting from such benefits is of such size, nature or incidence that its disclosure is relevant to an understanding of the entity's financial performance ~~to explain the performance of the enterprise for the period~~ (see IAS 18, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies Presentation of Financial Statements). ~~Where required by IAS 24, Related Party Disclosures, an enterprise discloses information about other long term employee benefits for key management personnel.~~

143. ~~[Deleted] Where required by IAS 24, Related Party Disclosures, an enterprise discloses information about termination benefits for key management personnel.~~

148. *An **enterprise entity** ~~should~~ **shall** also disclose:*

- (a) the fair value, at the beginning and end of the period, of the **entity's enterprise's** own equity financial instruments (other than share options) held by equity compensation plans; and*
- (b) the fair value, at the date of issue, of the **enterprise's entity's** own equity financial instruments (other than share options) issued by the **enterprise entity** to equity compensation plans or to employees, or by equity compensation plans to employees, during the period.*

*If it is ~~not practicable to determine~~ the fair value of the equity financial instruments (other than share options) **cannot be determined without undue cost or effort**, that fact should be disclosed.*

151. The disclosures required by paragraphs 147 and 148 are intended to meet the objectives of this Standard. Additional disclosure may be required to satisfy the requirements of IAS 24, Related Party Disclosures, if an ~~enterprise~~ **entity**

- ~~(a) provides equity compensation benefits to key management personnel;~~
- ~~(b) provides equity compensation benefits in the form of instruments issued by the enterprise's parent; or~~
- ~~(c) enters into related party transactions with equity compensation plans.~~

Amendments to IAS 20 (reformatted 1994), Accounting for Government Grants and Disclosure of Government Assistance

Paragraphs 20-22 of IAS 20 are amended to read as follows:

20. *A government grant that becomes receivable as compensation for expenses or losses already incurred or for the purpose of giving immediate financial support to the entity ~~enterprise~~ with no future related costs ~~should~~ shall be recognised as income of the period in which it becomes receivable, ~~as an extraordinary item if appropriate (see IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies).~~*
21. In ~~certain~~ some circumstances, a government grant may be awarded for the purpose of giving immediate financial support to an ~~enterprise~~ entity rather than as an incentive to undertake specific expenditures. Such grants may be confined to an individual ~~enterprise~~ entity and may not be available to a whole class of beneficiaries. These circumstances may warrant recognising a grant as income in the period in which the ~~enterprise~~ entity qualifies to receive it, ~~as an extraordinary item if appropriate,~~ with disclosure to ensure that its effect is clearly understood.
22. A government grant may become receivable by an ~~enterprise~~ entity as compensation for expenses or losses incurred in a previous accounting period. Such a grant is recognised as income of the period in which it becomes receivable, ~~as an extraordinary item if appropriate,~~ with disclosure to ensure that its effect is clearly understood.

Amendments to IAS 22 (revised 1998), Business Combinations

Paragraphs 3, 8, 54, 88, 91, 94-97 and 99 of IAS 22 are amended to read as follows:

3. A business combination may result in a parent-subsidary relationship in which the acquirer is the parent and the acquiree a subsidiary of the acquirer. In such circumstances, the acquirer applies this Standard in its consolidated financial statements. It includes its interest in the acquiree in its separate financial statements as an investment in a subsidiary (see IAS 27, Consolidated and Separate Financial Statements ~~and Accounting for Investments in Subsidiaries~~).

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

...

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

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

...

54. *The amortisation period and the amortisation method ~~should be~~ is reviewed at least at each financial year end. If the expected useful life of goodwill is significantly different from previous estimates, the amortisation period ~~should be~~ is changed accordingly. If there has been a significant change in the expected pattern of economic benefits from goodwill, the method ~~should be~~ is changed to reflect the changed pattern. Such changes ~~should be~~ are accounted for as changes in accounting estimates under IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors ~~Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies~~, by adjusting the amortisation charge for the current and future periods.*

88. *For goodwill, the financial statements ~~should~~ shall disclose:*

....

(e) *A reconciliation of the carrying amount of goodwill at the beginning and end of the period showing:*

....

(ix) *the gross amount and the accumulated amortisation (aggregated with accumulated impairment losses), at the end of the period.*

Comparative information is not required.

91. *For negative goodwill, the financial statements ~~should~~ shall disclose:*

....

(b) *a reconciliation of the carrying amount of negative goodwill at the beginning and end of the period showing:*

....

(viii) *the gross amount of negative goodwill and the accumulated amount of negative goodwill already recognised as income, at the end of the period.*

Comparative information is not required.

94. *For a business combination ~~which~~ that is a uniting of interests, the following additional disclosures ~~should~~ shall be made in the financial statements for the period during which the uniting of interests has taken place:*

(a) *description and number of shares issued, together with the percentage of each ~~enterprise's~~ entity's voting shares exchanged to effect the uniting of interests;*

(b) *amounts of assets and liabilities contributed by each ~~enterprise~~ entity; and*

(c) *sales revenue, other ~~operating~~ revenues, ~~extraordinary items~~ and the ~~net~~ profit or loss of each ~~enterprise~~ entity prior to the date of the combination that are included in the ~~net~~ profit or loss in shown by the combined entity's ~~enterprise's~~ financial statements.*

95. General disclosures required to be made in consolidated financial statements are contained in IAS 27, Consolidated and Separate Financial Statements and Accounting for Investments in Subsidiaries.
96. *For business combinations effected after the balance sheet date, the information required by paragraphs 86-94 shall ~~should~~ be disclosed. If this information cannot be obtained without undue cost or effort # is impracticable to disclose any of this information, this fact shall should be disclosed.*
97. Business combinations ~~which have been~~ effected after the balance sheet date and before the date on which the financial statements of one of the combining enterprises are authorised for issue are disclosed if they are of such importance that ~~non disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions~~ material and non-disclosure could influence the economic decisions of users taken on the basis of the financial statements (see IAS 10, Events After the Balance Sheet Date).
99. *At the date when this Standard becomes effective (or at the date of adoption, if earlier), it ~~should~~ shall be applied as set out in the following tables. In all cases other than those detailed in these tables, this Standard ~~should~~ shall be applied retrospectively, unless it is ~~impracticable~~ requires undue cost or effort to do so.*

Amendments to IAS 29 (reformatted 1994), Financial Reporting in Hyperinflationary Economies

Paragraphs 1, 8, 17, 22, 23, 31 and 39 of IAS 29 are amended to read as follows:

1. *This Standard ~~should~~ shall be applied to the primary financial statements, including the consolidated financial statements, of any enterprise entity that reports in whose functional currency is the currency of a hyperinflationary economy.*
8. *The financial statements of an enterprise entity that reports in whose functional currency is the currency of a hyperinflationary economy, whether they are based on a historical cost approach or a current cost approach, ~~should~~ shall be stated in terms of the measuring unit current at the balance sheet date. The corresponding figures for the previous period required by IAS 1, Presentation of Financial Statements, and any information in respect of earlier periods ~~should~~ shall also be stated in terms of the measuring unit current at the balance sheet date unless paragraph 40 (b) of IAS 21 (revised 200X), The Effects of Changes in Foreign Exchange Rates, applies.*
17. 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 ~~reporting~~ functional currency and a relatively stable foreign currency.
22. An enterprise entity may acquire assets under an arrangement that permits it to defer payment without incurring an explicit interest charge. Where it is ~~impracticable~~ would require undue cost or effort to impute the amount of interest, such assets are restated from the payment date and not the date of purchase.
23. ~~[Deleted] IAS 21, The Effects of Changes in Foreign Exchange Rates, permits an enterprise to include foreign exchange differences on borrowings in the carrying amount of assets following a severe and recent devaluation. Such a practice is not appropriate for an enterprise~~

~~reporting in the currency of a hyperinflationary economy when the carrying amount of the asset is restated from the date of its acquisition.~~

31. The gain or loss on the net monetary position is accounted for in accordance with paragraphs 27 and 28. ~~The current cost income statement may, however, already include an adjustment reflecting the effects of changing prices on monetary items in accordance with paragraph 16 of IAS 15, Information Reflecting the Effects of Changing Prices. Such an adjustment is part of the gain or loss on net monetary position.~~
39. *The following disclosures ~~should~~ 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 ~~reporting~~ functional currency and, as a result, are stated in terms of the measuring unit current at the balance sheet date;*

Amendments to IAS 31 (revised 2000), Financial Reporting of Interests in Joint Ventures

New paragraphs 3A, 25A, 32A and 38A are added, and paragraphs 1, 2, 25-28, 30-32, 34-38 and 42 of IAS 31 are amended, as follows:

1. *This Standard shall ~~should~~ be applied in accounting for interests in joint ventures and the reporting of joint venture assets, liabilities, income 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 interests in jointly controlled entities held by venture capital organisations, mutual funds, unit trusts and similar entities that are measured at fair value in accordance with IAS 39, Financial Instruments: Recognition and Measurement, when such measurement is well-established practice in those industries. When such investments are measured at fair value, changes in fair value are included in profit or loss in the period of the change.*
2. *The following terms are used in this Standard with the meanings specified:*

...

The equity method is a method of accounting and reporting 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 of the jointly controlled entity. ~~The income statement~~ The profit or loss of the venturer includes ~~reflects~~ the venturer's share of the profit results of operations of the jointly controlled entity.

...

Joint Control

- 3A. Joint control may be precluded when an investee is in legal reorganisation or in bankruptcy, or operates under severe long-term restrictions on its ability to transfer funds to the venturer.

Consolidated Financial Statements of a Venturer

Benchmark Treatment - Proportionate Consolidation

25. ~~In its consolidated financial statements, a~~ A ~~venturer shall should report recognise its interest in a jointly controlled entity using one of the two reporting formats for proportionate consolidation.~~

25A. An investor recognises its interest in a jointly controlled entity using one of the two reporting formats for proportionate consolidation irrespective of whether it also has investments in subsidiaries or whether it describes its financial statements as consolidated financial statements.

26. When reporting an interest in a jointly controlled entity ~~in consolidated financial statements~~, 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 through its share of the assets and liabilities of the venture. This substance and economic reality is reflected in the ~~consolidated~~ financial statements of the venturer when the venturer reports its interests in the assets, liabilities, income and expenses of the jointly controlled entity by using one of the two reporting formats for proportionate consolidation described in paragraph 28.

27. The application of proportionate consolidation means that the ~~consolidated~~ balance sheet 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 ~~consolidated~~ income statement of the venturer includes its share of the income 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 subsidiaries, which are set out in IAS 27, Consolidated and Separate Financial Statements ~~and Accounting for Investments in Subsidiaries~~.

28. Different reporting formats may be used to give effect to proportionate consolidation. The venturer may combine its share of each of the assets, liabilities, income and expenses of the jointly controlled entity with the similar items in its ~~consolidated~~ financial statements on a line-by-line basis. For example, it may combine its share of the jointly controlled entity's inventory with its ~~the~~ inventory ~~of the consolidated group~~ and its share of the jointly controlled entity's property, plant and

equipment with ~~its the~~ same items ~~of the consolidated group~~. Alternatively, the venturer may include separate line items for its share of the assets, liabilities, income and expenses of the jointly controlled entity in its ~~consolidated~~ financial statements. For example, it may show its share of ~~a the~~ current assets of the jointly controlled entity separately as part of ~~its the~~ current assets ~~of the consolidated group~~; it may show its share of the property, plant and equipment of the jointly controlled entity separately as part of ~~its the~~ property, plant and equipment ~~of the consolidated group~~. Both these reporting formats result in the reporting of identical amounts of ~~net profit or loss income~~ and of each major classification of assets, liabilities, income and expenses; both formats are acceptable for the purposes of this Standard.

30. *A venturer shall ~~should~~ discontinue the use of proportionate consolidation from the date on which it ceases to have joint control over a jointly controlled entity.*
31. 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 external restrictions are placed on the jointly controlled entity such that it ~~can~~ no longer has joint control ~~achieve its goals~~.

Allowed Alternative Treatment - Equity Method

32. *~~In its consolidated financial statements, a~~ A venturer shall ~~should~~ recognise ~~report~~ its interest in a jointly controlled entity using the equity method.*
- 32A. A venturer recognises its interest in a jointly controlled entity using the equity method irrespective of whether it also has investments in subsidiaries or whether it describes its financial statements as consolidated financial statements.
34. *A venturer shall ~~should~~ 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 Benchmark and Allowed Alternative Treatments

35. *A venturer ~~should account for the following interests~~ shall recognise an interest in a jointly controlled entity that is acquired and held exclusively with a view to its subsequent disposal within twelve*

months from acquisition in accordance with IAS 39, Financial Instruments: Recognition and Measurement at fair value, with changes in fair value included in profit or loss of the period of the change.

~~(a) an interest in a jointly controlled entity which is acquired and held exclusively with a view to its subsequent disposal in the near future; and~~

~~(b) an interest in a jointly controlled entity which operates under severe long-term restrictions that significantly impair its ability to transfer funds to the venturer.~~

36. ~~[Deleted] The use of either proportionate consolidation or the equity method is inappropriate when the interest in a jointly controlled entity is acquired and held exclusively with a view to its subsequent disposal in the near future. It is also inappropriate when the jointly controlled entity operates under severe long-term restrictions which significantly impair its ability to transfer funds to the venturer.~~

37. ~~From the date on which a jointly controlled entity becomes a subsidiary of a venturer, the venturer shall accounts for its interest in accordance with IAS 27, Consolidated and Separate Financial Statements and Accounting for Investments in Subsidiaries.~~

Separate Financial Statements of a Venturer

38. **An interest in a jointly controlled entity shall be accounted for in the venturer's separate financial statements (as described in paragraph 4 of IAS 27, Consolidated and Separate Financial Statements) in accordance with paragraphs 29, 30 and 33 of IAS 27.** ~~In many countries separate financial statements are presented by a venturer in order to meet legal or other requirements. Such separate financial statements are prepared in order to meet a variety of needs with the result that different reporting practices are in use in different countries. Accordingly, this Standard does not indicate a preference for any particular treatment.~~

38A. This Standard does not mandate which entities publish separate financial statements. Paragraph 38 applies when an entity prepares separate financial statements that purport to comply with International Financial Reporting Standards.

Reporting Interests in Joint Ventures in the Financial Statements of an Investor

42. *An investor in a joint venture, ~~that~~ ~~which~~ does not have joint control, ~~shall~~ ~~should report~~ recognise its investment interest in a joint venture in its ~~consolidated~~ financial statements in accordance with IAS 39, *Financial Instruments: Recognition and Measurement*, or, if it has significant influence in the joint venture, in accordance with IAS 28, *Accounting for Investments in Associates*. ~~In the separate financial statements of an investor that issues consolidated financial statements, it may also report the investment at cost.~~*

Amendment to IAS 32 (revised 1998), Financial Instruments: Disclosure and Presentation

Paragraph 85 of IAS 32 is amended to read as follows:

85. When disclosure of fair value information is omitted because it is ~~not practicable~~ would require undue cost or effort to determine fair value with sufficient reliability, information is provided to assist users of the financial statements in making their own judgements about the extent of possible differences between the carrying amount of financial assets and financial liabilities and their fair value. In addition to an explanation of the reason for the omission and the principal characteristics of the financial instruments that are pertinent to their value, information is provided about the market for the instruments. In some cases, the terms and conditions of the instruments disclosed in accordance with paragraph 47 may provide sufficient information about the characteristics of the instrument. When it has a reasonable basis for doing so, management may indicate its opinion as to the ~~relationship~~ between fair value and the carrying amount of financial assets and financial liabilities for which it is unable to determine fair value.

Amendments to IAS 34, Interim Financial Reporting

Paragraphs 17, 24-27 and 43-44 of IAS 34 are amended to read as follows:

17. Examples of the ~~kinds~~ types of disclosures ~~that are~~ required by paragraph 16 are set out below. Individual ~~International Accounting Standards~~ provide guidance regarding disclosures for many of these items:
- ...
- (h) ~~extraordinary items;~~
- (hi) any debt default or ~~any~~ breach of a debt covenant that has not been corrected subsequently; and
- (ij) related party transactions.
24. The Preface to International Accounting Standards states that ‘International Accounting Standards are not intended to apply to immaterial items.’ The Framework states that ‘information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.’ ~~IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies, requires separate disclosure of material extraordinary items, unusual ordinary items, discontinued operations, IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, requires disclosure regarding changes in accounting estimates, fundamental errors, and changes in accounting policies. IAS 8 does not contain quantified guidance as to materiality.~~
25. ~~While~~ Although judgement is ~~always~~ required in assessing materiality for financial reporting purposes, this Standard bases the recognition and disclosure decision on data for the interim period by itself for reasons of understandability of the interim figures financial report. Thus, for example, ~~unusual or extraordinary items, changes in accounting policies or estimates, and fundamental,~~ errors are recognised and disclosed based on materiality in relation to interim period data to avoid misleading inferences that might result from non-disclosure. The overriding goal is to ensure that an interim financial report includes all information ~~that is~~ relevant to understanding an

~~enterprise's~~ entity's financial position and performance during the interim period.

26. *If an estimate of an amount reported in an interim period is changed significantly during the final interim period of the financial year, but a separate financial report is not published for that final interim period, the nature and amount of that change in estimate ~~should~~ shall be disclosed in a note to the annual financial statements for that financial year.*
27. IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, requires disclosure of the nature and (if practicable) the amount of a change in estimate that either has a ~~material~~ an effect in the current period or is expected to have a ~~material~~ an effect in subsequent periods. IAS 8 also requires disclosure of the amount of the change, except where the expected amount of the effect in subsequent periods cannot be estimated without undue cost or effort. Paragraph 16(d) of this Standard requires similar disclosure in an interim financial report. Examples include changes in estimate in the final interim period relating to inventory write-downs, restructurings, or impairment losses that were reported in an earlier interim period of the financial year. The disclosure required by the preceding paragraph is consistent with the IAS 8 requirement and is intended to be narrow in scope relating only to the change in estimate. An ~~enterprise~~ entity is not required to include additional interim period financial information in its annual financial statements.
43. *A change in accounting policy, other than one for which the transition is specified by a new ~~International Accounting Standard~~, ~~should~~ shall be reflected by:*
- (a) ~~restating the financial statements of prior interim periods of the current financial year and the comparable interim periods of prior financial years (see paragraph 20), unless the restated information for a particular prior period cannot be obtained without undue cost or effort, if the enterprise follows the benchmark treatment under IAS 8; or~~*
 - (b) ~~restating the financial statements of prior interim periods of the current financial year, if the enterprise follows the allowed alternative treatment under IAS 8. In this case, comparable interim periods of prior financial years are not restated.~~*

44. One objective of the preceding principle is to ensure that a single accounting policy is applied to a particular class of transactions throughout an entire financial year. Under IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, a change in accounting policy is reflected by retrospective application, with restatement of prior period financial data, unless the restated information for a particular prior period cannot be obtained without undue cost or effort, if practicable. ~~However, if the amount of the adjustment relating to prior financial years is not reasonably determinable, then under IAS 8 the new policy is applied prospectively. An allowed alternative is to include the entire cumulative retrospective adjustment in the determination of net profit or loss for the period in which the accounting policy is changed.~~ The effect of the principle in paragraph 43 is to require that within the current financial year any change in accounting policy be applied retrospectively to the beginning of the financial year.

Amendments to IAS 35, Discontinuing Operations

Paragraphs 27, 32, 41, 42 and 50 of IAS 35 are amended to read as follows:

27. *An ~~enterprise entity~~ shall include in its financial statements the following information relating to a discontinuing operation ~~in its financial statements beginning with the financial statements for the period in which the initial disclosure event (as defined in paragraph 16) occurs:~~*

...

- (f) *the amounts of revenue, expenses, and pre-tax profit or loss ~~from ordinary activities~~ attributable to the discontinuing operation during the current financial reporting period, and the income tax expense relating thereto as required by paragraph 81(h) of IAS 12; and*

...

32. The asset disposals, liability settlements, and binding sale agreements referred to in the preceding paragraph may occur concurrently with the initial disclosure event, or in the period in which the initial disclosure event occurs, or in a later period. In accordance with IAS 10, Events After the Balance Sheet Date, if some of the assets attributable to a discontinuing operation have actually been sold or are the subject of one or more binding sale agreements entered into after the financial year end but before the board approves the financial statements for issue, the financial statements include the disclosures required by paragraph 31 ~~if non-disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions~~ the effects are material and non-disclosure could influence the economic decisions of users taken on the basis of the financial statements.

Not an Extraordinary Item

41. ~~[Deleted] A discontinuing operation should not be presented as an extraordinary item.~~

42. ~~[Deleted] IAS 8 defines extraordinary items as "income or expenses that arise from events or transactions that are clearly distinct from the~~

~~ordinary activities of the enterprise and therefore are not expected to recur frequently or regularly.” The two examples of extraordinary items cited in IAS 8 are expropriations of assets and natural disasters, both of which are types of events that are not within the control of the management of the enterprise. As defined in this Standard, a discontinuing operation must be based on a single plan by an enterprise’s management to sell or otherwise dispose of a major portion of the business.~~

50. ~~[Deleted] This Standard supersedes paragraphs 19-22 of IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.~~

Amendments to IAS 36, Impairment of Assets

Paragraphs 3, 9, 37, 38, 41, 42, 82, 91 and 96 of IAS 36 are amended to read as follows:

3. This Standard applies to:

- (a) subsidiaries, as defined in IAS 27, Consolidated and Separate Financial Statements and Accounting for Investments in Subsidiaries;

...

9. *In assessing whether there is any indication that an asset may be impaired, an entity ~~enterprise should~~ shall consider, as a minimum, the following indications:*

....

Internal sources of information

....

- (f) *significant changes with an adverse effect on the enterprise 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~~ and plans to dispose of an asset before the previously expected date; and*

37. *Future cash flows ~~should~~ shall be estimated for the asset in its current condition. Estimates of future cash flows ~~should~~ shall not include estimated future cash inflows or outflows that are expected to arise from:*

....

(c) future capital expenditure that will improve or enhance the asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made.

38. Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:

(b) future capital expenditure that will improve or enhance the asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made or the related future benefits from this future expenditure.

41. Until an ~~enterprise~~ entity incurs capital expenditure that improves or enhances an asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made, estimates of future cash flows do not include the estimated future cash inflows ~~that are~~ expected to arise from this expenditure (see Appendix A, Example 6).

42. Estimates of future cash flows include future capital expenditure necessary to maintain or sustain an asset at its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made.

82. The 'bottom-up' test ensures that an ~~enterprise~~ entity recognises any impairment loss that exists for a cash-generating unit, including for goodwill that can be allocated on a reasonable and consistent basis. Whenever it is ~~impracticable~~ requires undue cost or effort to allocate goodwill on a reasonable and consistent basis in the 'bottom-up' test, the combination of the 'bottom-up' and the 'top-down' test ensures that an ~~enterprise~~ entity recognises:

...

(a) first, any impairment loss that exists for the cash-generating unit excluding any consideration of goodwill; and

(b) .to the larger unit.

91. If ~~there is no practical way to estimate~~ the recoverable amount of each individual asset of a cash-generating unit cannot be estimated without undue cost or effort, this Standard requires an arbitrary allocation of an impairment loss between the assets of that unit, other than goodwill, because all assets of a cash-generating unit work together.

96. *In assessing whether there is any indication that an impairment loss recognised for an asset in prior years may no longer exist or may have decreased, an ~~enterprise~~ entity ~~should~~ shall consider, as a minimum, the following indications:*

....

Internal sources of information

....

- (d) *significant changes with a favourable effect on the ~~enterprise~~ 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 capital expenditure ~~that has been~~ incurred during the period to improve or enhance an asset in excess of its ~~originally assessed~~ standard of performance assessed immediately before the expenditure is made or a commitment to discontinue or restructure the operation to which the asset belongs; and*

....

Amendments to IAS 37, Provisions, Contingent Liabilities and Contingent Assets

Paragraphs 75, 86, 89, 91, 94 of IAS 37 and Appendix C of IAS 37 are amended to read as follows:

75. A management or board decision to restructure taken before the balance sheet date does not give rise to a constructive obligation at the balance sheet date unless the entity enterprise has, before the balance sheet 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 enterprise will carry out the restructuring.

~~In some cases, If an entity enterprise starts to implement a restructuring plan, or announces its main features to those affected, only after the balance sheet date, Ddisclosure ~~may be~~ is required under IAS 10, Events After the Balance Sheet Date, if the restructuring is material and non-disclosure could influence the economic decisions of users taken on the basis of the financial statements of such importance that its non disclosure would affect the ability of the users of the financial statements to make proper evaluations and decisions.~~

86. *Unless the possibility of any outflow in settlement is remote, an ~~enterprise~~ entity ~~should~~ shall disclose for each class of contingent liability at the balance sheet date a brief description of the nature of the contingent liability and, ~~where practicable~~ if the information can be obtained without undue cost or effort:*
- (a) *an estimate of its financial effect, measured under paragraphs 36-52;*
 - (b) *an indication of the uncertainties relating to the amount or timing of any outflow; and*
 - (c) *the possibility of any reimbursement.*

89. ~~Where~~ If an inflow of economic benefits is probable, an enterprise should *entity shall* disclose a brief description of the nature of the contingent assets at the balance sheet date, and, if the information can be obtained without undue cost or effort ~~where practicable~~, an estimate of their financial effect, measured using the principles set out for provisions in paragraphs 36-52.
91. ~~Where~~ If any of the information required by paragraphs 86 and 89 is not disclosed because it is ~~not practicable~~ requires undue cost or effort to do so, that fact should be stated.
94. The Standard requires a different treatment from IAS 8, ~~Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies~~ Accounting Policies, Changes in Accounting Estimates and Errors. IAS 8 requires comparative information to be restated (benchmark treatment) or additional pro forma comparative information on a restated basis to be disclosed (allowed alternative treatment) unless it is ~~impracticable~~ requires undue cost or effort to do so.

[The following example is added to Appendix C to IAS 37]

Example 12: Proposed dividends

Before the balance sheet date (31 December 2000), the Board of Directors announced the details of proposed dividend payments, subject to approval at the annual shareholders' meeting. The annual shareholders' meeting was held in March 2001 and the dividend payments were approved.

Present obligation as a result of a past obligating event - There is no obligation because no obligating event has taken place. The obligating event is approval by the shareholders at the shareholders' meeting.

Conclusion

No provision is recognised at 31 December 2000 (see paragraph 14).

Amendments to IAS 38, Intangible Assets

Paragraphs 2, 7, 24, 26, 34, 54, 60, 61, 80, 88-90, 93-95, 97, 103-105, 107, 113 and 118 of IAS 38 are amended and new paragraphs 24A-24C, 34A, 34B, 104A-104C, 121A and 121B are added.

2. If another International Accounting Standard deals with a specific type of intangible asset, an ~~entity~~ ~~enterprise~~ applies that Standard instead of this Standard. For example, this Standard does not apply to:

...

- (f) financial assets as defined in IAS 32, Financial Instruments: Disclosure and Presentation. The recognition and measurement of some financial assets are covered by: IAS 27, Consolidated and Separate Financial Statements ~~and Accounting for Investments in Subsidiaries~~; IAS 28, Accounting for Investments in Associates; IAS 31, Financial Reporting of Interests in Joint Ventures; and IAS 39, Financial Instruments: Recognition and Measurement.

Definitions

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

....

The ~~r~~Residual value of an intangible asset is the estimated ~~net~~ amount ~~that~~ ~~which~~ ~~an~~ ~~the~~ ~~entity~~ ~~enterprise~~ would currently expects to obtain ~~from~~ ~~for~~ disposal of the ~~an~~ asset at the end of its useful life, after deducting the ~~expected~~ estimated costs of disposal, if the asset were of the age and in the condition expected at the end of its estimated useful life.

...

24. The cost of an intangible asset comprises:
 - (a) its purchase price, including any import duties and non-refundable purchase taxes, after deducting any trade discounts and rebates; and

- (b) any directly attributable expenditure on preparing the asset for its intended use.

24A. Directly attributable expenditure includes, for example:

- (a) costs of employee benefits (as defined in IAS 19, Employee Benefits) arising directly from bringing the asset to its working condition.
- (b) ~~professional fees for legal services. Any trade discounts and rebates are deducted in arriving at the cost.~~

24B. Because capitalisation of costs ceases when an intangible asset is in the working condition necessary for it to be capable of operating in the manner intended by management, costs incurred in using or redeploying intangible assets (as distinct from improving the assets' standard of performance) are excluded from the cost of those assets. For example, the following costs are excluded from the cost of an intangible asset:

- (a) costs incurred while the asset is capable of operating in the manner intended by management, but has yet to be brought into use;
- (b) initial operating losses, such as those incurred while demand for the asset's outputs builds up.

24C. Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the working condition necessary for it to be capable of operating in the manner intended by management. These incidental operations may occur before or during the development activities. Because incidental operations are not necessary to bring an asset to the working condition necessary for it to be capable of operating in the manner intended by management, the income and related expenses of incidental operations are recognised in profit or loss for the period, and included in their respective classifications of income and expense in the income statement.

26. If an intangible asset is acquired in exchange for equity instruments of the reporting ~~entity~~ enterprise, the cost of the asset is the fair value of the equity instruments issued, ~~which is equal to the fair value of the asset.~~ The fair value of the item received is used to measure its cost if it is more clearly evident than the fair value of the equity instruments issued.

34. An intangible asset may be acquired in exchange or part exchange for another dissimilar intangible asset or another asset. Except when paragraph 34B applies, ~~t~~he cost of such an item is measured at the fair value of the asset received, which is equivalent to the fair value of the asset given up, adjusted by the amount of any cash or cash equivalents transferred. The fair value of the asset received is used to measure its cost if it is more clearly evident than the fair value of the asset given up.
- 34A. Paragraph 19(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. To determine whether the cost of an intangible asset acquired with consideration other than cash or other monetary assets can be measured reliably, an entity considers the guidance in paragraphs 28-30. An entity will be unable to determine reliably the fair value of an intangible asset when comparable market transactions are infrequent and alternative estimates of fair value (for example, based on discounted cash flow projections) cannot be calculated.
- 34B. The cost of an intangible asset acquired in exchange for a similar asset is measured at the carrying amount of the asset given up when the fair value of neither of the assets exchanged can be determined reliably.
35. ~~[Deleted] An intangible asset may be acquired in exchange for a similar asset that has a similar use in the same line of business and that has a similar fair value. An intangible asset may also be sold in exchange for an equity interest in a similar asset. In both cases, since the earnings process is incomplete, no gain or loss is recognised on the transaction. Instead, the cost of the new asset is the carrying amount of the asset given up. However, the fair value of the asset received may provide evidence of an impairment loss in the asset given up. Under these circumstances an impairment loss is recognised for the asset given up and the carrying amount after impairment is assigned to the new asset.~~
54. The cost of an internally generated intangible asset comprises all expenditure that can be directly attributed, ~~or allocated on a reasonable and consistent basis,~~ and is necessary to creating, producing, and preparing the asset for it to be capable of operating in the manner its intended by management use. The cost includes, if applicable:
- (a) expenditure on materials and services used or consumed in generating the intangible asset;

- (b) the salaries, wages and other employment related costs of personnel directly engaged in generating the asset; and
- (c) any expenditure that is directly attributable to generating the asset, such as fees to register a legal right and the amortisation of patents and licences that are used to generate the asset; ~~and~~
- ~~(d) overheads that are necessary to generate the asset and that can be allocated on a reasonable and consistent basis to the asset (for example, an allocation of the depreciation of property, plant and equipment, insurance premiums and rent). Allocations of overheads are made on bases similar to those used in allocating overheads to inventories (see IAS 2, Inventories). IAS 23, Borrowing Costs, establishes criteria for the recognition of interest as a component of the cost of an internally generated intangible asset.~~

60. *Subsequent expenditure on an intangible asset after its purchase or its completion ~~should~~ shall be recognised as an expense when, and only when, it is incurred unless:*

- (a) *it is probable that this expenditure ~~will enable the asset to generate~~ increases the future economic benefits embodied in the asset in excess of its originally assessed standard of performance assessed immediately before the expenditure was made; and*
- (b) *this expenditure can be measured and attributed to the asset reliably.*

If these conditions are met, the subsequent expenditure ~~should~~ shall be added to the cost of the intangible asset.[†]

61. Subsequent expenditure on a recognised intangible asset is recognised as an expense if this expenditure is required to maintain the asset at its ~~originally assessed~~ assessed immediately before the expenditure was made. The nature of intangible assets is such that, in many cases, it is not possible to determine whether subsequent expenditure is likely to enhance or maintain the future economic benefits that will flow to the enterprise from embodied in those assets. In addition, it is often difficult to attribute such expenditure directly to a particular intangible asset rather than the

[†]See also SIC – 6, Costs of Modifying Existing Software.

business as a whole. Therefore, only rarely will expenditure incurred after the initial recognition of a purchased intangible asset or after completion of an internally generated intangible asset result in additions to the cost of the intangible asset.

80. As the future economic benefits embodied in an intangible asset are consumed over time, the carrying amount of the asset is reduced to reflect that consumption. This is achieved by systematic allocation of the cost or revalued amount of the asset, less any residual value, as an expense over the asset's useful life. Amortisation is recognised whether or not there has been an increase in, for example, the asset's fair value or recoverable amount. Many factors are need to be considered in determining the useful life of an intangible asset, including:
- (a) the expected usage of the asset by the entity ~~enterprise~~ and whether the asset could be managed efficiently ~~managed~~ by another management team;
 - (b) typical product life cycles for the asset and public information on estimates of useful lives of similar types of assets that are used in a similar way;
 - (c) technical, technological, commercial or other types of obsolescence;
 - (d) the stability of the industry in which the asset operates and changes in the market demand for the products or services output from the asset;
 - (e) expected actions by competitors or potential competitors;
 - (f) the level of maintenance expenditure required to obtain the expected future economic benefits from the asset and the ~~company's~~ entity's ability and intent to reach such a level;
 - (g) the period of control over the asset and legal or similar limits on the use of the asset, such as the expiry dates of related leases; and
 - (h) whether the useful life of the asset is dependent on the useful life of other assets of the entity ~~enterprise~~.
88. *The amortisation method used ~~should~~ shall reflect the pattern in which the asset's future economic benefits are expected to be consumed by the enterprise entity. If that pattern cannot be determined reliably, the straight-line method should be used. The*

amortisation charge for each period ~~should~~ shall be recognised as an expense unless another ~~International Accounting Standard~~ permits or requires it to be included in the carrying amount of another asset.

89. A variety of amortisation 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. The method used for an asset is selected based on the expected pattern of consumption of the future economic benefits embodied in the asset and is ~~consistently~~ applied consistently from period to period, unless there is a change in the expected pattern of consumption of ~~those future economic benefits to be derived from that asset~~. There ~~will~~ rarely, if ever, ~~is~~ be persuasive evidence to support an amortisation method for intangible assets that results in a lower amount of accumulated amortisation than under the straight-line method.
90. Amortisation is usually recognised as an expense. However, sometimes, the future economic benefits embodied in an asset are absorbed by the ~~enterprise~~ entity in producing other assets rather than giving rise to an expense. In these cases, the amortisation charge forms part of the cost of the other asset and is included in its carrying amount. For example, the amortisation of intangible assets used in a production process is included in the carrying amount of inventories (see IAS 2, Inventories).
93. ~~If the benchmark treatment is adopted, An estimate of an asset's the residual value is based on the amount recoverable from disposal is estimated using prices prevailing at the date of the estimate acquisition of the asset, for the sale of a similar asset that has reached the end of its estimated useful life and that has operated under conditions similar to those in which the asset will be used. The residual value is reviewed as at each balance sheet date, not subsequently increased for changes in prices or value. If the allowed alternative treatment is adopted, a new estimate of residual value is made at the date of each revaluation of the asset using prices prevailing at that date. A change in the asset's residual value, other than a change reflected in an impairment loss recognised under IAS 36, Impairment of Assets, is accounted for prospectively as an adjustment to future amortisation.~~
94. *The amortisation period and the amortisation method ~~should~~ shall be reviewed at least at each financial year end. If the expected useful life of the asset is ~~significantly~~ different from previous estimates, the amortisation period ~~should~~ shall be changed*

accordingly. If there has been a ~~significant~~ change in the expected pattern of consumption of the future economic benefits embodied from in the asset, the amortisation method ~~should~~ shall be changed to reflect the changed pattern. Such changes ~~should~~ shall be accounted for as changes in accounting estimates under IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies Accounting Policies, Changes in Accounting Estimates and Errors, by adjusting the amortisation charge for the current and future periods.

95. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the useful life may be extended by subsequent expenditure that improves the condition of the asset ~~beyond the originally assessed standard of performance~~. Also, the recognition of an impairment loss may indicate that the amortisation period needs to be changed.

95A. A change in the amortisation method is a change in the technique used to apply the entity's accounting policy to recognise amortisation as an asset's future economic benefits are consumed. Therefore, it is a change in accounting estimate.

103. An intangible asset ~~should~~ shall be derecognised (eliminated from the balance sheet) on:

(a) disposal; or

(b) when no future economic benefits are expected from its use or and subsequent disposal.

104. Gains or losses arising from the retirement or disposal of an intangible asset ~~should~~ shall be determined as the difference between the net disposal proceeds and the carrying amount of the asset ~~and should~~. They shall be recognised as income or expense in the income statement for the period in which the retirement or disposal occurs (unless IAS 17, Leases, requires otherwise on a sale and leaseback).

104A. The disposal of an intangible asset may occur by sale or by entering into a finance lease. In determining the date of disposal of such an item, an entity applies the criteria in IAS 18, Revenue, for recognising revenue from the sale of goods. IAS 17, Leases, applies to disposal by a sale and leaseback.

104B. The consideration receivable on disposal of an intangible asset is recognised initially at fair value. If payment for such an intangible asset is deferred, the consideration received is recognised initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognised as interest revenue under IAS 18 according to the effective yield on the receivable.

105. [Deleted] If an intangible asset is exchanged for a similar asset under the circumstances described in paragraph 35, the cost of the acquired asset is equal to the carrying amount of the asset disposed of and no gain or loss results.

107. The financial statements ~~should~~ shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:

...

(e) *a reconciliation of the carrying amount at the beginning and end of the period showing:*

...

(vii) *net exchange differences arising on the translation of the financial statements into a different presentation currency, and on the translation of a foreign operation entity into the presentation currency of the reporting entity; and*

(viii) *other changes in the carrying amount during the period.*

Comparative information is not required.

111. The financial statements should also disclose:

...

(e) *the amount of contractual commitments for the acquisition of intangible assets.*

113. If intangible assets are carried at revalued amounts, the following shall ~~should~~ be disclosed:

(a) by class of intangible assets:

...

(iii) the carrying amount that would have been recognised ~~included~~ in the financial statements had the revalued class of intangible assets been carried under the benchmark treatment in paragraph 63; and

(c) the methods and significant assumptions applied in estimating the asset fair values.

118. At the date when this Standard becomes effective (or at the date of adoption, if earlier), it ~~should~~ shall be applied as set out in the following tables. In all cases other than those detailed in these tables, this Standard ~~should~~ shall be applied retrospectively, unless retrospective application requires undue cost or effort ~~it is impracticable to do so.~~

121A. The amendments to the initial measurement of assets acquired in exchange for a similar intangible asset specified in paragraphs 34 and 34B shall be applied prospectively.

121B. If an exchange of assets was measured on the basis of the carrying amount of the asset given up, under paragraph 35 in IAS 38 (revised 1998), the entity does not restate the carrying amount of the asset acquired to reflect the fair value of the consideration given. Therefore, on adoption of this Standard, an entity does not apply the general treatment of changes in accounting policies in IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

Amendments to IAS 40, Investment Property

Paragraphs 20, 22, 23, 67, 69 and 71 of IAS 40 are amended and new paragraph 21A is added.

20. The cost of an investment property is not increased by start-up costs (unless they are necessary to bring the property to its working condition for it to be capable of operating in the manner intended by management), initial operating losses incurred before the investment property achieves the planned level of occupancy or abnormal amounts of wasted material, labour or other resources incurred in constructing or developing the property.

21A. If an investment property is acquired in exchange for equity instruments of the reporting entity, the cost of the investment property is the fair value of the equity instruments issued. The fair value of the investment property received is used to measure its cost if it is more clearly evident than the fair value of the equity instruments issued.

22. *Subsequent expenditure relating to an investment property that has already been recognised ~~should~~ shall be added to the carrying amount of the investment property when, and only when, it is probable that it increases the future economic benefits; embodied in the investment property in excess of its the originally assessed standard of performance assessed immediately before the expenditure was made. of the existing investment property, will flow to the enterprise. All other subsequent expenditure ~~should~~ shall be recognised as an expense in the period in which it is incurred.*

23. ~~The appropriate accounting treatment for~~ Whether expenditure incurred after ~~subsequently to~~ the acquisition of an investment property increases the future economic benefits embodied in the investment property depends on the circumstances ~~which~~ that were taken into account ~~on the initial measurement and recognition of the related investment in assessing the investment property's standard of performance (including the level of maintenance assumed in the most recent estimate of its useful life) immediately before the expenditure.~~ For example instance, when the carrying amount of an investment property ~~already takes into account a loss in future economic benefits has been written down to recognise an impairment, the~~ subsequent expenditure ~~to restore the future economic benefits expected from the~~

asset is capitalised to the extent that it causes the impairment loss to be reversed. This is also the case Subsequent expenditure also is capitalised when the purchase price of an asset reflects the enterprise's obligation need to incur that expenditure that is necessary in the future to bring the asset to its working condition. An example of this is ~~might be~~ the acquisition of a building requiring renovation. In such circumstances, the subsequent expenditure is added to the asset's carrying amount.

67. *In addition to the disclosure required by paragraph 66, an enterprise entity that applies the fair value model in paragraphs 27-49 ~~should~~ shall also disclose a reconciliation of the carrying amount of investment property at the beginning and end of the period showing the following (~~comparative information is not required~~):*

...

- (e) *the net exchange differences arising on the translation of the financial statements into a different presentation currency, and on the translation of a foreign entity operation into the presentation currency of the reporting enterprise;*

69. *In addition to the disclosure required by paragraph 66, an enterprise entity that applies the cost model in paragraph 50 ~~should~~ shall also disclose:*

...

- (d) *a reconciliation of the carrying amount of investment property at the beginning and end of the period showing the following (~~comparative information is not required~~):*

71. This Standard requires a different treatment from ~~the benchmark and allowed alternative treatments for change in accounting policies under that required by IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies.~~ IAS 8 requires comparative information to be restated (~~benchmark treatment~~) or additional pro forma comparative information on a restated basis to be disclosed (~~allowed alternative treatment~~) unless it is impracticable to do so except in respect of particular prior periods for which restatement of comparative information would require undue cost or effort.

Amendments to IAS 41, Agriculture

Paragraphs 39 and 53 of IAS 41 are amended as follows:

39. ~~[Deleted] An enterprise should present the carrying amount of its biological assets separately on the face of its balance sheet.~~
53. Agricultural activity is often exposed to climatic, disease, and other natural risks. If an event occurs that, because of ~~its~~ the size, nature, or incidence of resulting items of income and expense is relevant to an understanding of the entity's enterprise's financial performance for the period, the nature and amount of ~~related~~ those items of income and expense are disclosed under IAS 18, Presentation of Financial Statements ~~Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies~~. Examples include an outbreak of a virulent disease, a flood, severe droughts or frosts, and a plague of insects.

Amendments and Withdrawals of SIC Interpretations

SIC-7 and SIC-13 are amended.

SIC-1, SIC-2, SIC-3, SIC-6, SIC-11, SIC-14, SIC-18, SIC-19, SIC-20, SIC-23, SIC-30 and SIC-33 are withdrawn.

These proposals are explained below.

SIC-1, Consistency – Different Cost Formulas for Inventories

This interpretation is withdrawn because it is covered in SIC-18, Consistency – Alternative Methods, which is incorporated into IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

SIC-2, Consistency – Capitalisation of Borrowing Costs

This interpretation is withdrawn because it is covered in SIC-18, Consistency – Alternative Methods, which is incorporated into IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

SIC-3, Elimination of Unrealised Profits and Losses or Transactions with Associates

This interpretation is withdrawn because it has been incorporated into IAS 28, Accounting for Investments in Associates.

SIC-6, Costs of Modifying Existing Software

This interpretation is withdrawn as the criteria in IAS 16, Property, Plant and Equipment, for capitalising subsequent expenditure are now based on the asset's "standard of performance assessed immediately before the expenditure is made".

Amendments to SIC 7, Introduction of the Euro

Paragraphs 4(a), 4(b), 6 and 8 of SIC-7 are amended to read as follows:

4. This means that, in particular:

- (a) foreign currency monetary assets and liabilities resulting from transactions ~~should~~ shall continue to be translated into the

functional reporting currency at the closing rate. Any resultant exchange differences ... (anticipatory hedges);

- (b) cumulative exchange differences relating to the translation of financial statements of foreign ~~entities~~ operations ~~should~~ shall continue to be classified as equity and ~~should~~ shall be recognised as income or expense only on the disposal of the net investment in the foreign ~~entity~~ operation; and
6. IAS 21.3 states that the Standard does not deal with hedge accounting ~~except in restricted circumstances~~. Therefore, this Interpretation ... with the related income or expense in a future period.
8. ~~[Deleted] Under the Allowed Alternative Treatment of IAS 21.21, exchange differences resulting from severe devaluations of currencies are included in the carrying amount of the related assets in certain limited circumstances. Those circumstances do not apply to the currencies participating in the changeover since the event of severe devaluation is incompatible with the required stability of participating currencies.~~

SIC-11, Foreign Exchange – Capitalisation of Losses Resulting from Severe Currency Devaluations

This Interpretation is withdrawn because of the elimination of the Allowed Alternative in IAS 21, The Effects of Changes in Foreign Exchange Rates.

Amendments to SIC-13, Jointly Controlled Entities – Non-Monetary Contributions by Venturers

Paragraphs 5, 6 and 11 of SIC-13, Jointly Controlled Entities – Non-Monetary Contributions by Venturers, are amended to read as follows:

- 5. In applying IAS 31.39 to non-monetary contributions to a JCE in exchange for an equity interest in the JCE, a venturer shall recognise in the income statement for the period the portion of a gain or loss attributable to the equity interests of the other venturers except when:
 - (a) the significant risks and rewards of ownership of the contributed non-monetary asset(s) have not been transferred to the JCE; or
 - (b) the gain or loss on the non-monetary contribution cannot be measured reliably; ~~or~~
 - ~~(c) the non-monetary assets contributed are similar to those contributed by the other venturers. Non-monetary assets are~~

~~similar to those contributed by other venturers when they have a similar nature, a similar use in the same line of business and a similar fair value. A contribution meets the similarity test only of all of the significant component assets thereof are similar to those contributed by the other venturers.~~

~~Where any If either of the exceptions (a) and (b) through (e) applies, the gain or loss is would be considered unrealised and would is therefore not be recognised in the income statement unless Pparagraph 6 also applies.~~

6. If, in addition to receiving an equity interest in the JCE, a venturer receives monetary or non-monetary assets ~~dissimilar to those it contributed~~, an appropriate portion of gain or loss on the transaction should be recognised by the venturer in the income statement.

11. ~~[Deleted] IAS 18.12 explains that “when good and services are exchanged or swapped for goods or services which are of similar nature and value, the exchange is not regarded as a transaction which generates revenue”. IAS 16.22 (revised 1998) says that “an item of property, plant and equipment may be exchanged for a similar asset that has a similar use in the same line of business and which has a similar face value. An item of property, plant and equipment may also be sold in exchange for an equity interest in a similar asset. In both cases, since the earning process is incomplete, no gain or loss is recognised on the transaction.” The same rationale applied to a contribution on non monetary assets since a contribution to a JCE is, in substance, an exchange of assets with the other ventures at the level of the JCE.~~

SIC-14, Property, Plant and Equipment – Compensation for the Impairment or Loss of Items

This interpretation is withdrawn because it has been incorporated into IAS 16, Property, Plant and Equipment (see proposed paragraphs 53A and 53B).

SIC-18, Consistency – Alternative Methods

This Interpretation is withdrawn because it has been incorporated into IAS 8, Accounting Policies, Changes in Accounting Estimates and Errors.

SIC-19, Reporting Currency – Measurement and Presentation of Financial Statements under IAS 21 and IAS 29

This Interpretation is withdrawn because it has been incorporated into IAS 21, The Effects of Changes in Foreign Exchange Rates.

SIC-20, Equity Accounting Method – Recognition of Losses

This interpretation is withdrawn because this topic is now included in IAS 28, Accounting for Investments in Associates.

SIC-23, Property, Plant and Equipment – Major Inspection or Overhaul Costs

This Interpretation is withdrawn because it has been incorporated into IAS 16, Property, Plant and Equipment.

SIC-24, Earnings Per Share – Financial Instruments and Other Contracts that May Be Settled in Shares

This interpretation is withdrawn. This topic is now included in IAS 33, Earnings Per Share.

SIC-30, Reporting Currency – Translation from Measurement Currency to Presentation Currency

This interpretation is withdrawn because it has been incorporated into IAS 21, The Effects of Changes in Foreign Exchange Rates.

SIC-33, Consolidation and Equity Method – Potential Voting Rights and Allocation of Ownership Interests

This interpretation is withdrawn because it has been incorporated into IAS 28, Accounting for Investments in Associates.