

**International Public Sector
Accounting Standards Board®**

**Handbook of International
Public Sector Accounting
Pronouncements**

***2014 Edition
Volume II***

International Federation of Accountants®
529 Fifth Avenue, 6th Floor
New York, New York 10017 USA

This publication was published by the International Federation of Accountants (IFAC®). Its mission is to: contributing to the development of high-quality standards and guidance; facilitating the adoption and implementation of high-quality standards and guidance; contributing to the development of strong professional accountancy organizations and accounting firms and to high-quality practices by professional accountants, and promoting the value of professional accountants worldwide; and speaking out on public interest issues. This publication may be accessed on the IPSASB® website: www.ipsasb.org.

International Public Sector Accounting Standards, Exposure Drafts, Consultation Papers, Recommended Practice Guidelines, and other IPSASB publications are published by, and copyright of, IFAC.

The IPSASB and IFAC do not accept responsibility for loss caused to any person who acts or refrains from acting in reliance on the material in this publication, whether such loss is caused by negligence or otherwise.

The IPSASB logo, 'International Public Sector Accounting Standards Board®', 'IPSASB', 'International Public Sector Accounting Standards' 'IPSAS', 'Recommended Practice Guidelines,' the IFAC logo, 'International Federation of Accountants', and 'IFAC' are trademarks and service marks of IFAC.

Copyright © June 2014 by the International Federation of Accountants (IFAC). All rights reserved. Written permission from IFAC is required to reproduce, store, transmit, or make other similar uses of this document, except as permitted by law. Contact permissions@ifac.org.

ISBN: 978-1-60815-182-0

Published by:



TABLE OF CONTENTS

VOLUME II

	Page
IPSAS 26—Impairment of Cash-Generating Assets	850
IPSAS 27—Agriculture	909
IPSAS 28—Financial Instruments: Presentation	937
IPSAS 29—Financial Instruments: Recognition and Measurement	1025
IPSAS 30—Financial Instruments: Disclosures	1295
IPSAS 31—Intangible Assets	1345
IPSAS 32—Service Concession Arrangements: Grantor	1399
Introduction to the International Public Sector Accounting Standard under the Cash Basis of Accounting	1459
Cash Basis IPSAS—Financial Reporting Under the Cash Basis of Accounting	1460
Introduction to Recommended Practice Guidelines	1584
RPG 1—Reporting on the Long-Term Sustainability of an Entity’s Finances	1585
RPG 2—Financial Statement Discussion and Analysis	1616
Glossary of Defined Terms for IPSASs 1–32	1627
Accrual IPSASs on Issue at January 15, 2014	1666
Summary of Other Documents	1676

IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 36, *Impairment of Assets*, published by the International Accounting Standards Board (IASB). Extracts from IAS 36 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IFRSs, IASs, Exposure Drafts, and other publications of the IASB are copyright of the IFRS Foundation.

“IFRS,” “IAS,” “IASB,” “IFRS Foundation,” “International Accounting Standards,” and “International Financial Reporting Standards” are trademarks of the IFRS Foundation and should not be used without the approval of the IFRS Foundation.

IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 15, 2014.

IPSAS 26, *Impairment of Cash-Generating Assets* was issued in February 2008.

Since then, IPSAS 26 has been amended by the following IPSASs:

- *Improvements to IPSASs 2011* (issued October 2011)
- *Improvements to IPSASs* (issued January 2010)
- IPSAS 27, *Agriculture* (issued December 2009)
- IPSAS 29, *Financial Instruments: Recognition and Measurement* (issued January 2010)
- IPSAS 31, *Intangible Assets* (issued January 2010)
- *Improvements to IPSASs* (issued November 2010)

Table of Amended Paragraphs in IPSAS 26

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
2	Amended	IPSAS 27 December 2009 IPSAS 29 January 2010 IPSAS 31 January 2010
8	Amended	IPSAS 27 December 2009 IPSAS 29 January 2010
9	Amended	IPSAS 29 January 2010
27	Amended	Improvements to IPSASs November 2010
123	Amended	Improvements to IPSASs January 2010
126A	New	Improvements to IPSASs January 2010
126B	New	Improvements to IPSASs January 2010

Paragraph Affected	How Affected	Affected By
126C	New	IPSAS 31 January 2010

IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS**CONTENTS**

	Paragraph
Objective	1
Scope	2–12
Definitions	13–20
Cash-Generating Assets	14–18
Depreciation	19
Impairment	20
Identifying an Asset that may be Impaired	21–30
Measuring Recoverable Amount	31–70
Measuring the Recoverable Amount of an Intangible Asset with an Indefinite Useful Life	37
Fair Value less Costs to Sell	38–42
Value in Use	43–70
Basis for Estimates of Future Cash Flows	46–51
Composition of Estimates of Future Cash Flows	52–66
Foreign Currency Future Cash Flows	67
Discount Rate	68–70
Recognizing and Measuring an Impairment Loss of an Individual Asset	71–75
Cash-Generating Units	76–97
Identifying the Cash-Generating Unit to which an Asset Belongs ..	77–84
Recoverable Amount and Carrying Amount of a Cash-Generating Unit	85–90
Impairment Loss for a Cash-Generating Unit	91–97
Reversing an Impairment Loss	98–111
Reversing an Impairment Loss for an Individual Asset	106–109
Reversing an Impairment Loss for a Cash-Generating Unit	110–111

Redesignation of Assets	112–113
Disclosure	114–125
Disclosure of Estimates used to Measure Recoverable Amounts of Cash-Generating Units Containing Intangible Assets with Indefinite Useful Lives.....	123–125
Effective Date.....	126–127
Appendix A: Application Guidance	
Appendix B: Amendments to Other IPSASs	
Basis for Conclusions	
Illustrative Decision Tree	
Implementation Guidance	
Comparison with IAS 36	

International Public Sector Accounting Standard 26, *Impairment of Cash-Generating Assets*, is set out in paragraphs 1–127. All the paragraphs have equal authority. IPSAS 26 should be read in the context of its objective, the Basis for Conclusions, and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the procedures that an entity applies to determine whether a cash-generating asset is impaired, and to ensure that impairment losses are recognized. This Standard also specifies when an entity should reverse an impairment loss, and prescribes disclosures.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for the impairment of cash-generating assets, except for:**
 - (a) **Inventories** (see IPSAS 12, *Inventories*);
 - (b) **Assets arising from construction contracts** (see IPSAS 11, *Construction Contracts*);
 - (c) **Financial assets that are within the scope of IPSAS 29, *Financial Instruments: Recognition and Measurement***;
 - (d) **Investment property that is measured at fair value** (see IPSAS 16, *Investment Property*);
 - (e) **Cash-generating property, plant, and equipment that is measured at revalued amounts** (see IPSAS 17, *Property, Plant, and Equipment*);
 - (f) **Deferred tax assets** (see the relevant international or national accounting standard dealing with deferred tax assets);
 - (g) **Assets arising from employee benefits** (see IPSAS 25, *Employee Benefits*);
 - (h) **Cash-generating intangible assets that are measured at revalued amounts** (see IPSAS 31, *Intangible Assets*);
 - (i) **Goodwill**;
 - (j) **Biological assets related to agricultural activity that are measured at fair value less costs to sell** (see IPSAS 27, *Agriculture*);
 - (k) **Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts**;
 - (l) **Non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value, less costs to sell, in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations; and**

- (m) **Other cash-generating assets in respect of which accounting requirements for impairment are included in another Standard.**
3. **This Standard applies to all public sector entities other than Government Business Enterprises.**
 4. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.
 5. GBEs apply IAS 36, *Impairment of Assets*, and therefore are not subject to the provisions of this Standard. Public sector entities, other than GBEs, that hold non-cash-generating assets as defined in paragraph 13 apply IPSAS 21, *Impairment of Non-Cash-Generating Assets*, to such assets. Public sector entities, other than GBEs, that hold cash-generating assets apply the requirements of this Standard.
 6. This Standard excludes cash-generating intangible assets that are regularly revalued to fair value from its scope. This Standard includes all other cash-generating intangible assets (for example, those that are carried at cost less any accumulated amortization) within its scope.
 7. This Standard excludes goodwill from its scope. Entities apply the requirements of the relevant international or national accounting standards dealing with the impairment of goodwill, the allocation of goodwill to cash-generating units, and the testing for impairment of cash-generating units with goodwill.
 8. This Standard does not apply to inventories and cash-generating assets arising from construction contracts, because existing standards applicable to these assets contain requirements for recognizing and measuring such assets. This Standard does not apply to deferred tax assets, assets related to employee benefits, or deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts. The impairment of such assets is addressed in the relevant international or national accounting standards. In addition, this Standard does not apply to (a) biological assets related to agricultural activity that are measured at fair value less costs to sell, and (b) non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value less costs to sell. IPSAS 27 dealing with biological assets related to agricultural activity, and the relevant international or national accounting standards dealing with non-current assets (or disposal groups) classified as held for sale, contain measurement requirements.
 9. This Standard does not apply to any financial assets that are included in the scope of IPSAS 28, *Financial Instruments: Presentation*. Impairment of these assets is dealt with in IPSAS 29.

10. This Standard does not require the application of an impairment test to an investment property that is carried at fair value in accordance with IPSAS 16. Under the fair value model in IPSAS 16, an investment property is carried at fair value at the reporting date, and any impairment will be taken into account in the valuation.
11. This Standard does not require the application of an impairment test to cash-generating assets that are carried at revalued amounts under the revaluation model in IPSAS 17. Under the revaluation model in IPSAS 17, assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date, and any impairment will be taken into account in that valuation.
12. Investments in:
 - (a) Controlled entities, as defined in IPSAS 6, *Consolidated and Separate Financial Statements*;
 - (b) Associates, as defined in IPSAS 7, *Investments in Associates*; and
 - (c) Joint ventures, as defined in IPSAS 8, *Interests in Joint Ventures*,
 are financial assets that are excluded from the scope of IPSAS 29. Where such investments are in the nature of cash-generating assets, they are dealt with under this Standard. Where these assets are in the nature of non-cash-generating assets, they are dealt with under IPSAS 21.

Definitions

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

A **cash-generating unit** is the smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.

Recoverable amount is the higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use.

Value in use of a cash-generating asset is the present value of the estimated future cash flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life.

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

Cash-Generating Assets

14. Cash-generating assets are assets held with the primary objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Holding an asset to generate a “commercial return” indicates that an entity intends to (a) generate positive cash inflows from the asset (or from the cash-generating unit of which the asset is a part), and (b) earn a commercial return that reflects the risk involved in holding the asset. An asset may be held with the primary objective of generating a commercial return even though it does not meet that objective during a particular reporting period. Conversely, an asset may be a non-cash-generating asset even though it may be breaking even or generating a commercial return during a particular reporting period. Unless stated otherwise, references to “an asset” or “assets” in the following paragraphs of this Standard are references to “cash-generating asset(s).”
15. There are a number of circumstances in which public sector entities may hold some assets with the primary objective of generating a commercial return, although the majority of their assets are not held for that purpose. For example, a hospital may deploy a building for fee-paying patients. Cash-generating assets of a public sector entity may operate independently of the non-cash-generating assets of the entity. For example, the deeds office may earn land registration fees independently from the department of land affairs.
16. In certain instances, an asset may generate cash flows although it is primarily held for service delivery purposes. For example, a waste disposal plant is operated to ensure the safe disposal of medical waste generated by state-controlled hospitals, but the plant also treats a small amount of medical waste generated by other private hospitals on a commercial basis. The treatment of medical waste from the private hospitals is incidental to the activities of the plant, and the assets that generate cash flows cannot be distinguished from the non-cash-generating assets.
17. In other instances an asset may generate cash flows and also be used for non-cash-generating purposes. For example, a public hospital has ten wards, nine of which are used for fee-paying patients on a commercial basis, and the other is used for non-fee-paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 21. If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies this Standard, rather than IPSAS 21.
18. In some cases it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases it is necessary to evaluate the significance of the cash flows. It may be difficult to determine

whether the extent to which the asset generates cash flows is so significant that this Standard is applicable, rather than IPSAS 21. Judgment is needed to determine which Standard to apply. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets and with the related guidance in paragraphs 14–17. Paragraph 114 requires an entity to disclose the criteria used in making this judgment. However, given the overall objectives of most public sector entities other than GBEs, the presumption is that assets are non-cash-generating in these circumstances and, therefore, IPSAS 21 will apply.

Depreciation

19. Depreciation and amortization are the systematic allocation of the depreciable amount of an asset over its useful life. In the case of an intangible asset, the term “amortization” is generally used instead of “depreciation.” Both terms have the same meaning.

Impairment

20. This Standard defines an “impairment” as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset’s future economic benefits or service potential through depreciation. Impairment of a cash-generating asset, therefore, reflects a decline in the future economic benefits or service potential embodied in an asset to the entity that controls it. For example, an entity may have a municipal parking garage that is currently being used at 25 percent of capacity. It is held for commercial purposes, and management has estimated that it generates a commercial rate of return when usage is at 75 percent of capacity and above. The decline in usage has not been accompanied by a significant increase in parking charges. The asset is regarded as impaired because its carrying amount exceeds its recoverable amount.

Identifying an Asset that may be Impaired

21. An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 25–27 describe some indications that an impairment loss may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. Except for the circumstances described in paragraph 23, this Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present.
22. **An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset.**

23. **Irrespective of whether there is any indication of impairment, an entity shall also test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during the reporting period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognized during the current reporting period, that intangible asset shall be tested for impairment before the end of the current reporting period.**
24. **The ability of an intangible asset to generate sufficient future economic benefits or service potential to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.**
25. **In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:**

External sources of information

- (a) **During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;**
- (b) **Significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic, or legal environment in which the entity operates, or in the market to which an asset is dedicated;**
- (c) **Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially;**

Internal sources of information

- (d) **Evidence is available of obsolescence or physical damage of an asset;**
- (e) **Significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to**

which an asset belongs, plans to dispose of an asset before the previously expected date, and reassessing the useful life of an asset as finite rather than indefinite;

- (eA) **A decision to halt the construction of the asset before it is complete or in a usable condition; and**
 - (f) **Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.**
26. The list in paragraph 25 is not exhaustive. An entity may identify other indications that an asset may be impaired, and these would also require the entity to determine the asset's recoverable amount.
27. Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:
- (a) Cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;
 - (b) Actual net cash flows or surplus or deficit flowing from the asset that are significantly worse than those budgeted;
 - (c) A significant decline in budgeted net cash flows or surplus, or a significant increase in budgeted loss, flowing from the asset; or
 - (d) Deficits or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.
28. As indicated in paragraph 23, this Standard requires an intangible asset with an indefinite useful life or an intangible asset that is not yet available for use to be tested for impairment, at least annually. Apart from when the requirements in paragraph 23 apply, the concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated. For example, if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 25.
29. As an illustration of paragraph 28, if market interest rates or other market rates of return on investments have increased during the period, an entity is not required to make a formal estimate of an asset's recoverable amount in the following cases:
- (a) If the discount rate used in calculating the asset's value in use is unlikely to be affected by the increase in these market rates. For

example, increases in short-term interest rates may not have a material effect on the discount rate used for an asset that has a long remaining useful life.

- (b) If the discount rate used in calculating the asset's value in use is likely to be affected by the increase in these market rates, but previous sensitivity analysis of recoverable amount shows that:
 - (i) It is unlikely that there will be a material decrease in recoverable amount because future cash flows are also likely to increase (for example, in some cases, an entity may be able to demonstrate that it adjusts its revenues (mainly exchange revenues) to compensate for any increase in market rates); or
 - (ii) The decrease in recoverable amount is unlikely to result in a material impairment loss.
- 30. If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortization) method, or the residual value for the asset needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognized for the asset.

Measuring Recoverable Amount

- 31. This Standard defines "recoverable amount" as the higher of an asset's fair value less costs to sell and its value in use. Paragraphs 32–70 set out the requirements for measuring recoverable amount. These requirements use the term "an asset" but apply equally to an individual asset or a cash-generating unit.
- 32. It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.
- 33. It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value in use as its recoverable amount.
- 34. If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, as the future cash flows from continuing use of the asset until its disposal are likely to be negligible.

35. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs 85–90), unless either:
 - (a) The asset's fair value less costs to sell is higher than its carrying amount; or
 - (b) The asset is a part of a cash-generating unit but is capable of generating cash flows individually, in which case the asset's value in use can be estimated to be close to its fair value less costs to sell and the asset's fair value less costs to sell can be determined.
36. In some cases, estimates, averages and computational shortcuts may provide reasonable approximations of the detailed computations for determining fair value less costs to sell or value in use.

Measuring the Recoverable Amount of an Intangible Asset with an Indefinite Useful Life

37. Paragraph 23 requires an intangible asset with an indefinite useful life to be tested for impairment annually by comparing its carrying amount with its recoverable amount, irrespective of whether there is any indication that it may be impaired. However, the most recent detailed calculation of such an asset's recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period, provided all of the following criteria are met:
 - (a) If the intangible asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets and is therefore tested for impairment as part of the cash-generating unit to which it belongs, the assets and liabilities making up that unit have not changed significantly since the most recent recoverable amount calculation;
 - (b) The most recent recoverable amount calculation resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and
 - (c) Based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the asset's carrying amount is remote.

Fair Value less Costs to Sell

38. The best evidence of an asset's fair value less costs to sell is the price in a binding sale agreement in an arm's length transaction, adjusted for

incremental costs that would be directly attributable to the disposal of the asset.

39. If there is no binding sale agreement but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, provided that there has not been a significant change in economic circumstances between the transaction date and the date as at which the estimate is made.
40. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available that reflects the amount that an entity could obtain, at the reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity considers the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale.
41. Costs of disposal, other than those that have been recognized as liabilities, are deducted in determining fair value less costs to sell. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits and costs associated with reducing or reorganizing a business following the disposal of an asset are not direct incremental costs to dispose of the asset.
42. Sometimes, the disposal of an asset would require the buyer to assume a liability, and only a single fair value less costs to sell is available for both the asset and the liability. Paragraph 89 explains how to deal with such cases.

Value in Use

43. **The following elements shall be reflected in the calculation of an asset's value in use:**
 - (a) **An estimate of the future cash flows the entity expects to derive from the asset;**
 - (b) **Expectations about possible variations in the amount or timing of those future cash flows;**
 - (c) **The time value of money, represented by the current market risk-free rate of interest;**
 - (d) **The price for bearing the uncertainty inherent in the asset; and**
 - (e) **Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.**

44. Estimating the value in use of an asset involves the following steps:
 - (a) Estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and
 - (b) Applying the appropriate discount rate to those future cash flows.
45. The elements identified in paragraph 43(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, i.e., the weighted average of all possible outcomes. The Application Guidance provides additional guidance on the use of present value techniques in measuring an asset's value in use.

Basis for Estimates of Future Cash Flows

46. **In measuring value in use, an entity shall:**
 - (a) **Base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence;**
 - (b) **Base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified; and**
 - (c) **Estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.**
47. Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided that the effects of

subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

48. Detailed, explicit, and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason, management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that these projections are reliable, and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.
49. Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts, using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information about patterns over a product or industry lifecycle. If appropriate, the growth rate is zero or negative.
50. When conditions are favorable, competitors may enter the market and restrict growth. Therefore, entities will have difficulty in exceeding the average historical growth rate over the long term (say, twenty years) for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used.
51. In using information from financial budgets/forecasts, an entity considers whether the information reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

Composition of Estimates of Future Cash Flows

52. **Estimates of future cash flows shall include:**
 - (a) **Projections of cash inflows from the continuing use of the asset;**
 - (b) **Projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and**
 - (c) **Net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.**
53. Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation. Therefore, if the discount rate includes the effect of price increases attributable to general inflation, future cash flows are estimated in nominal terms. If the discount rate

excludes the effect of price increases attributable to general inflation, future cash flows are estimated in real terms (but include future specific price increases or decreases).

54. Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.
55. When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale. For example, this is the case for a building under construction or for a development project that is not yet completed.
56. To avoid double-counting, estimates of future cash flows do not include:
 - (a) Cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables); and
 - (b) Cash outflows that relate to obligations that have been recognized as liabilities (for example, payables, pensions, or provisions).
57. **Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:**
 - (a) **A future restructuring to which an entity is not yet committed; or**
 - (b) **Improving or enhancing the asset's performance.**
58. Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:
 - (a) Future cash outflows or related cost savings (for example, reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an entity is not yet committed; or
 - (b) Future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.
59. A restructuring is a program that is (a) planned and controlled by management, and (b) materially changes either the scope of the entity's activities or the manner in which those activities are carried out. IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, contains guidance clarifying when an entity is committed to a restructuring.

60. When an entity becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the entity is committed to the restructuring:
 - (a) Its estimates of future cash inflows and cash outflows for the purpose of determining value in use reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts approved by management); and
 - (b) Its estimates of future cash outflows for the restructuring are included in a restructuring provision in accordance with IPSAS 19.
61. Until an entity incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the increase in economic benefits or service potential associated with the expected cash outflow.
62. Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits or service potential expected to arise from the asset in its current condition. When a unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.
63. **Estimates of future cash flows shall not include:**
 - (a) **Cash inflows or outflows from financing activities; or**
 - (b) **Income tax receipts or payments.**
64. Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. Because the time value of money is considered by discounting the estimated future cash flows, these cash flows exclude cash inflows or outflows from financing activities. Similarly, since the discount rate is determined on a pre-tax basis, future cash flows are also determined on a pre-tax basis.
65. **The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life shall be the amount that an entity expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.**

66. The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life is determined in a similar way to an asset's fair value less costs to sell, except that, in estimating those net cash flows:
- (a) An entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used; and
 - (b) The entity adjusts those prices for the effect of both future price increases due to general inflation and specific future price increases or decreases. However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, the entity also excludes this effect from the estimate of net cash flows on disposal.

Foreign Currency Future Cash Flows

67. Future cash flows are estimated in the currency in which they will be generated, and then discounted using a discount rate appropriate for that currency. An entity translates the present value using the spot exchange rate at the date of the value in use calculation.

Discount Rate

68. **The discount rate (rates) shall be a pre-tax rate (rates) that reflect(s) current market assessments of:**
- (a) **The time value of money, represented by the current risk-free rate of interest; and**
 - (b) **The risks specific to the asset for which the future cash flow estimates have not been adjusted.**
69. A rate that reflects current market assessments of the time value of money and the risks specific to the asset is the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing, and risk profile equivalent to those that the entity expects to derive from the asset. This rate is estimated from the rate implicit in current market transactions for similar assets. However, the discount rate(s) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted. Otherwise, the effect of some assumptions will be double-counted.
70. When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. The Application Guidance provides additional guidance on estimating the discount rate in such circumstances.

Recognizing and Measuring an Impairment Loss of an Individual Asset

71. Paragraphs 72–75 set out the requirements for recognizing and measuring impairment losses for an individual asset. The recognition and measurement of impairment losses for cash-generating units are dealt with in paragraphs 76–97.
72. **If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss.**
73. **An impairment loss shall be recognized immediately in surplus or deficit.**
74. **When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognize a liability if, and only if, that is required by another Standard.**
75. **After the recognition of an impairment loss, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Cash-Generating Units

76. Paragraphs 77–97 set out the requirements for identifying the cash-generating unit to which an asset belongs and determining the carrying amount of, and recognizing impairment losses for, cash-generating units.

Identifying the Cash-Generating Unit to which an Asset Belongs

77. **If there is any indication that an asset may be impaired, the recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).**
78. The recoverable amount of an individual asset cannot be determined if:
 - (a) The asset's value in use cannot be estimated to be close to its fair value less costs to sell (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and
 - (b) The asset does not generate cash inflows that are largely independent of those from other assets and is not capable of generating cash flows individually.

In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit.

79. As defined in paragraph 13, an asset's cash-generating unit is the smallest group of assets that (a) includes the asset, and (b) generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash-generating unit involves judgment. If recoverable amount cannot be determined for an individual asset, an entity identifies the lowest aggregation of assets that generate largely independent cash inflows.
80. Cash inflows are inflows of cash and cash equivalents received from parties external to the entity. In identifying whether cash inflows from an asset (or group of assets) are largely independent of the cash inflows from other assets (or groups of assets), an entity considers various factors, including how management (a) monitors the entity's operations (such as by product lines, businesses, individual locations, districts, or regional areas), or (b) makes decisions about continuing or disposing of the entity's assets and operations. The Implementation Guidance gives an example of the identification of a cash-generating unit.
81. **If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a cash-generating unit, even if some or all of the output is used internally. If the cash inflows generated by any asset or cash-generating unit are affected by internal transfer pricing, an entity shall use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:**
 - (a) **The future cash inflows used to determine the asset's or cash-generating unit's value in use; and**
 - (b) **The future cash outflows used to determine the value in use of any other assets or cash-generating units that are affected by the internal transfer pricing.**
82. Even if part or all of the output produced by an asset or a group of assets is used by other units of the entity (for example, products at an intermediate stage of a production process), this asset or group of assets forms a separate cash-generating unit if the entity could sell the output on an active market. This is because the asset or group of assets could generate cash inflows that would be largely independent of the cash inflows from other assets or groups of assets. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, or to any other asset or cash-generating unit affected by internal transfer pricing, an entity adjusts this information if internal transfer prices do not reflect management's best estimate of future prices that could be achieved in arm's length transactions.
83. **Cash-generating units shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified.**

84. If an entity determines that an asset belongs to a cash-generating unit different from that in previous periods, or that the types of assets aggregated for the asset's cash-generating unit have changed, paragraph 120 requires disclosures about the cash-generating unit if an impairment loss is recognized or reversed for the cash-generating unit.

Recoverable Amount and Carrying Amount of a Cash-Generating Unit

85. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs to sell and its value in use. For the purpose of determining the recoverable amount of a cash-generating unit, any reference in paragraphs 31–70 to an asset is read as a reference to a cash-generating unit.
86. **The carrying amount of a cash-generating unit shall be determined on a basis consistent with the way the recoverable amount of the cash-generating unit is determined.**
87. The carrying amount of a cash-generating unit:
- (a) Includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and will generate the future cash inflows used in determining the cash-generating unit's value in use; and
 - (b) Does not include the carrying amount of any recognized liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability.

This is because fair value less costs to sell and value in use of a cash-generating unit are determined excluding cash flows that relate to assets that are not part of the cash-generating unit and liabilities that have been recognized (see paragraphs 41 and 56).

88. When assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate, or are used to generate, the relevant stream of cash inflows. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. The Illustrated Decision Tree provides a flow diagram illustrating the treatment of individual assets that are part of cash-generating units.
89. It may be necessary to consider some recognized liabilities to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to assume the liability. In this case, the fair value less costs to sell (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the estimated selling price for the assets of the cash-generating unit and the liability together, less the costs of disposal. To perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying

amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount.

90. For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of (a) assets that are not part of the cash-generating unit (for example, receivables or other financial assets), or (b) liabilities that have been recognized (for example, payables, pensions and other provisions). In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Impairment Loss for a Cash-Generating Unit

91. **An impairment loss shall be recognized for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the cash-generating assets of the unit on a pro rata basis, based on the carrying amount of each asset in the unit. These reductions in carrying amounts shall be treated as impairment losses on individual assets and recognized in accordance with paragraph 73.**
92. **In allocating an impairment loss in accordance with paragraph 91, an entity shall not reduce the carrying amount of an asset below the highest of:**
 - (a) **Its fair value less costs to sell (if determinable);**
 - (b) **Its value in use (if determinable); and**
 - (c) **Zero.**

The amount of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other cash-generating assets of the unit.

93. **Where a non-cash-generating asset contributes to a cash-generating unit, a proportion of the carrying amount of that non-cash-generating asset shall be allocated to the carrying amount of the cash-generating unit prior to estimation of the recoverable amount of the cash-generating unit. The carrying amount of the non-cash-generating asset shall reflect any impairment losses at the reporting date that have been determined under the requirements of IPSAS 21.**
94. If the recoverable amount of an individual asset cannot be determined (see paragraph 78):
 - (a) An impairment loss is recognized for the asset if its carrying amount is greater than the higher of its fair value less costs to sell and the results of the allocation procedures described in paragraphs 91–93; and

- (b) No impairment loss is recognized for the asset if the related cash-generating unit is not impaired. This applies even if the asset's fair value less costs to sell is less than its carrying amount.
- 95. In some cases, non-cash-generating assets contribute to cash-generating units. This Standard requires that, where a cash-generating unit subject to an impairment test contains a non-cash-generating asset, that non-cash-generating asset is tested for impairment in accordance with the requirements of IPSAS 21. A proportion of the carrying amount of that non-cash-generating asset, following that impairment test, is included in the carrying amount of the cash-generating unit. The proportion reflects the extent to which the service potential of the non-cash-generating asset contributes to the cash-generating unit. The allocation of any impairment loss for the cash-generating unit is then made on a pro rata basis to all cash-generating assets in the cash-generating unit, subject to the limits in paragraph 92. The non-cash-generating asset is not subject to a further impairment loss beyond that which has been determined in accordance with IPSAS 21.
- 96. Where an asset releases service potential to one or more cash-generating activities, but not to non-cash-generating activities, entities refer to the relevant international and national accounting standard dealing with such circumstances.
- 97. **After the requirements in paragraphs 91–93 have been applied, a liability shall be recognized for any remaining amount of an impairment loss for a cash-generating unit if, and only if, that is required by another standard.**

Reversing an Impairment Loss

- 98. Paragraphs 99–105 set out the requirements for reversing an impairment loss recognized for an asset or a cash-generating unit in prior periods. These requirements use the term “an asset,” but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 106–109 and, for a cash-generating unit, in paragraphs 110 and 111.
- 99. **An entity shall assess at each reporting date whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset.**
- 100. **In assessing whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:**

External sources of information

- (a) **The asset's market value has increased significantly during the period;**
- (b) **Significant changes with a favorable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic, or legal environment in which the entity operates or in the market to which the asset is dedicated;**
- (c) **Market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially;**

Internal sources of information

- (d) **Significant changes with a favorable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or the manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs;**
- (dA) **A decision to resume construction of the asset that was previously halted before it was completed or in a usable condition; and**
- (e) **Evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.**

- 101. Indications of a potential decrease in an impairment loss in paragraph 100 mainly mirror the indications of a potential impairment loss in paragraph 25.
- 102. If there is an indication that an impairment loss recognized for an asset may no longer exist or may have decreased, this may indicate that (a) the remaining useful life, (b) the depreciation (amortization) method, or (c) the residual value may need to be reviewed and adjusted in accordance with the standard applicable to the asset, even if no impairment loss is reversed for the asset.
- 103. **An impairment loss recognized in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. That increase is a reversal of an impairment loss.**

104. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or from sale, since the date when an entity last recognized an impairment loss for that asset. An entity is required to identify the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include:
- (a) A change in the basis for recoverable amount (i.e., whether recoverable amount is based on fair value less costs to sell or value in use);
 - (b) If recoverable amount was based on value in use, a change in the amount or timing of estimated future cash flows, or in the discount rate; or
 - (c) If recoverable amount was based on fair value less costs to sell, a change in estimate of the components of fair value less costs to sell.
105. An asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the unwinding of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Reversing an Impairment Loss for an Individual Asset

106. **The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years.**
107. Any increase in the carrying amount of an asset above the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years is a revaluation. In accounting for such a revaluation, an entity applies the standard applicable to the asset.
108. **A reversal of an impairment loss for an asset shall be recognized immediately in surplus or deficit.**
109. **After a reversal of an impairment loss is recognized, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Reversing an Impairment Loss for a Cash-Generating Unit

110. **A reversal of an impairment loss for a cash-generating unit shall be allocated to the cash-generating assets of the unit pro rata with the carrying amounts of those assets. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and**

recognized in accordance with paragraph 108. No part of the amount of such a reversal shall be allocated to a non-cash-generating asset contributing service potential to a cash-generating unit.

111. In allocating a reversal of an impairment loss for a cash-generating unit in accordance with paragraph 110, the carrying amount of an asset shall not be increased above the lower of:
 - (a) Its recoverable amount (if determinable); and
 - (b) The carrying amount that would have been determined (net of amortization or depreciation) if no impairment loss had been recognized for the asset in prior periods.

The amount of the reversal of the impairment loss that would otherwise have been allocated to the asset shall be allocated pro rata to the other assets of the unit.

Redesignation of Assets

112. The redesignation of an asset from a cash-generating asset to a non-cash-generating asset or from a non-cash-generating asset to a cash-generating asset shall only occur when there is clear evidence that such a redesignation is appropriate. A redesignation, by itself, does not necessarily trigger an impairment test or a reversal of an impairment loss. At the subsequent reporting date after a redesignation, an entity shall consider, as a minimum, the listed indications in paragraph 25.
113. There are circumstances in which public sector entities may decide that it is appropriate to redesignate a cash-generating asset as a non-cash-generating asset. For example, an effluent treatment plant was constructed primarily to treat industrial effluent from an industrial estate at commercial rates, and excess capacity has been used to treat effluent from a social housing unit, for which no charge is made. The industrial estate has recently closed and, in future, the site will be developed for social housing purposes. In light of the closure of the industrial estate, the public sector entity decides to redesignate the effluent treatment plant as a non-cash-generating asset.

Disclosure

114. An entity shall disclose the criteria developed by the entity to distinguish cash-generating assets from non-cash-generating assets.
115. An entity shall disclose the following for each class of assets:
 - (a) The amount of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of financial performance in which those impairment losses are included.

- (b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period, and the line item(s) of the statement of financial performance in which those impairment losses are reversed.**
- 116. In some cases it may be not be clear whether the primary objective of holding an asset is to generate a commercial return. That judgment is needed to determine whether to apply this Standard or IPSAS 21. Paragraph 114 requires the disclosure of the criteria used for distinguishing cash-generating and non-cash-generating assets.
- 117. A class of assets is a grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements.
- 118. The information required in paragraph 115 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant, and equipment at the beginning and end of the period, as required by IPSAS 17.
- 119. **An entity that reports segment information in accordance with IPSAS 18, *Segment Reporting*, shall disclose the following for each reported segment based on an entity's reporting format:**
 - (a) **The amount of impairment losses recognized in surplus or deficit during the period; and**
 - (b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period.**
- 120. **An entity shall disclose the following for each material impairment loss recognized or reversed during the period for a cash-generating asset or a cash-generating unit:**
 - (a) **The events and circumstances that led to the recognition or reversal of the impairment loss;**
 - (b) **The amount of the impairment loss recognized or reversed;**
 - (c) **For a cash-generating asset:**
 - (i) **The nature of the asset; and**
 - (ii) **If the entity reports segment information in accordance with IPSAS 18, the reported segment to which the asset belongs, based on the entity's reporting format.**
 - (d) **For a cash-generating unit:**

- (i) **A description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, or a reported segment);**
 - (ii) **The amount of the impairment loss recognized or reversed by class of assets, and, if the entity reports segment information in accordance with IPSAS 18, by reported segment based on the entity's reporting format; and**
 - (iii) **If the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), a description of the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified.**
- (e) **Whether the recoverable amount of the asset is its fair value less costs to sell or its value in use;**
 - (f) **If the recoverable amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market); and**
 - (g) **If the recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.**
121. **An entity shall disclose the following information for the aggregate impairment losses and the aggregate reversals of impairment losses recognized during the period for which no information is disclosed in accordance with paragraph 120:**
- (a) **The main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses; and**
 - (b) **The main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.**
122. **An entity is encouraged to disclose assumptions used to determine the recoverable amount of assets during the period. However, paragraph 123 requires an entity to disclose information about the estimates used to measure the recoverable amount of a cash-generating unit when an intangible asset with an indefinite useful life is included in the carrying amount of that unit.**

Disclosure of Estimates used to Measure Recoverable Amounts of Cash-Generating Units Containing Intangible Assets with Indefinite Useful Lives

123. **An entity shall disclose the information required by (a)–(e) for each cash-generating unit for which the carrying amount of intangible assets with**

indefinite useful lives allocated to that unit is significant in comparison with the entity's total carrying amount of intangible assets with indefinite useful lives:

- (a) The carrying amount of intangible assets with indefinite useful lives allocated to the unit;**
- (b) The basis on which the unit's recoverable amount has been determined (i.e., value in use or fair value less costs to sell);**
- (c) If the unit's recoverable amount is based on value in use:**
 - (i) A description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's recoverable amount is most sensitive;**
 - (ii) A description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information;**
 - (iii) The period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit, an explanation of why that longer period is justified;**
 - (iv) The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit is dedicated; and**
 - (v) The discount rate(s) applied to the cash flow projections.**
- (d) If the unit's recoverable amount is based on fair value less costs to sell, the methodology used to determine fair value less costs to sell. If fair value less costs to sell is not determined using an observable market price for the unit, the following information shall also be disclosed:**
 - (i) A description of each key assumption on which management has based its determination of fair value less costs to sell.**

Key assumptions are those to which the unit's recoverable amount is most sensitive; and

- (ii) A description of management's approach to determining the value (or values) assigned to each key assumption, whether those values reflect past experience or, if appropriate, are consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information.**

If fair value less costs to sell is determined using discounted cash flow projections, the following information shall also be disclosed:

- (iii) The period over which management has projected cash flows;**
 - (iv) The growth rate used to extrapolate cash flow projections; and**
 - (v) The discount rate(s) applied to the cash flow projections.**
- (e) If a reasonably possible change in a key assumption on which management has based its determination of the unit's recoverable amount would cause the unit's carrying amount to exceed its recoverable amount:**
- (i) The amount by which the unit's recoverable amount would exceed its carrying amount;**
 - (ii) The value assigned to the key assumption; and**
 - (iii) The amount by which the value assigned to the key assumption must change, after incorporating any consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's recoverable amount to be equal to its carrying amount.**

- 124. If some or all of the carrying amount of intangible assets with indefinite useful lives is allocated across multiple cash-generating units, and the amount so allocated to each unit is not significant in comparison with the entity's total carrying amount of intangible assets with indefinite useful lives, that fact shall be disclosed, together with the aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units. In addition, if (a) the recoverable amounts of any of those units are based on the same key assumption(s), and (b) the aggregate carrying amount of intangible assets with indefinite useful lives allocated to them is significant in comparison with the entity's total carrying amount of intangible assets with indefinite useful lives, an entity shall disclose that fact, together with:**

- (a) **The aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units;**
 - (b) **A description of the key assumption(s);**
 - (c) **A description of management's approach to determining the value(s) assigned to the key assumption(s), whether those value(s) reflect past experience or, if appropriate, are consistent with external sources of information, and if not, how and why they differ from past experience or external sources of information;**
 - (d) **If a reasonably possible change in the key assumption(s) would cause the aggregate of the units' carrying amounts to exceed the aggregate of their recoverable amounts:**
 - (i) **The amount by which the aggregate of the units' recoverable amounts would exceed the aggregate of their carrying amounts;**
 - (ii) **The value(s) assigned to the key assumption(s); and**
 - (iii) **The amount by which the value(s) assigned to the key assumption(s) must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units' recoverable amounts to be equal to the aggregate of their carrying amounts.**
125. The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit may, in accordance with paragraph 37, be carried forward and used in the impairment test for that unit in the current period, provided specified criteria are met. When this is the case, the information for that unit that is incorporated into the disclosures required by paragraphs 123 and 124 relate to the carried forward calculation of recoverable amount.

Effective Date

126. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after April 1, 2009. Earlier application is encouraged. If an entity applies this Standard for a period beginning before April 1, 2009, it shall disclose that fact.**
- 126A. **Paragraphs 25 and 100 were amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply those amendments prospectively for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged if an entity also applies the amendments to paragraphs 12, 13, 29, 40, 57, 59, 62, 62A, 62B, 63, 66, and 101A of IPSAS 16 at the same time. If an entity applies the**

amendments for a period beginning before January 1, 2011, it shall disclose that fact.

- 126B. Paragraph 123 was amended by *Improvements to IPSASs* issued in January 2010. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2011. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2011, it shall disclose that fact.**
- 126C. IPSAS 31 amended paragraph 2(h). An entity shall apply that amendment for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies IPSAS 31 for a period beginning before April 1, 2011, the amendment shall also be applied for that earlier period.**
- 127. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 26.

Using Present Value Techniques to Measure Value in Use

This guidance uses the term “asset,” but equally applies to a group of assets forming a cash-generating unit.

The Components of a Present Value Measurement

- AG1. The following elements together capture the economic differences between cash-generating assets:
- (a) An estimate of the future cash flow, or, in more complex cases, series of future cash flows that the entity expects to derive from the asset;
 - (b) Expectations about possible variations in the amount or timing of those cash flows;
 - (c) The time value of money, represented by the current market risk-free rate of interest;
 - (d) The price for bearing the uncertainty inherent in the asset; and
 - (e) Other, sometimes unidentifiable, factors (such as illiquidity) that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.
- AG2. This appendix contrasts two approaches to computing present value, either of which may be used to estimate the value in use of an asset, depending on the circumstances. Under the traditional approach, adjustments for factors (b)–(e) described in paragraph A1 are embedded in the discount rate. Under the expected cash flow approach, factors (b), (d) and (e) cause adjustments in arriving at risk-adjusted expected cash flows. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result should be to reflect the expected present value of the future cash flows, i.e., the weighted average of all possible outcomes.

General Principles

- AG3. The techniques used to estimate future cash flows and interest rates will vary from one situation to another depending on the circumstances surrounding the asset in question. However, the following general principles govern any application of present value techniques in measuring assets:

- (a) Interest rates used to discount cash flows should reflect assumptions that are consistent with those inherent in the estimated cash flows. Otherwise, the effect of some assumptions will be double-counted or ignored. For example, a discount rate of 12 percent might be applied to contractual cash flows of a loan receivable. That rate reflects expectations about future defaults from loans with particular characteristics. That same 12 percent rate should not be used to discount expected cash flows, because those cash flows already reflect assumptions about future defaults.
- (b) Estimated cash flows and discount rates should be free from both bias and factors unrelated to the asset in question. For example, deliberately understating estimated net cash flows to enhance the apparent future profitability of an asset introduces a bias into the measurement.
- (c) Estimated cash flows or discount rates should reflect the range of possible outcomes rather than a single most likely minimum or maximum possible amount.

Traditional and Expected Cash Flow Approaches to Present Value

Traditional Approach

- AG4. Accounting applications of present value have traditionally used a single set of estimated cash flows and a single discount rate, often described as the rate commensurate with the risk. In effect, the traditional approach assumes that a single discount rate convention can incorporate all the expectations about the future cash flows and the appropriate risk premium. Therefore, the traditional approach places most of the emphasis on selection of the discount rate.
- AG5. In some circumstances, such as those in which comparable assets can be observed in the marketplace, a traditional approach is relatively easy to apply. For assets with contractual cash flows, it is consistent with the manner in which marketplace participants describe assets, as in a 12 percent bond.
- AG6. However, the traditional approach may not appropriately address some complex measurement problems, such as the measurement of non-financial assets for which no market for the item or a comparable item exists. A proper search for the rate commensurate with the risk requires analysis of at least two items – an asset that exists in the marketplace and has an observed interest rate and the asset being measured. The appropriate discount rate for the cash flows being measured must be inferred from the observable rate of interest in that other asset. To draw that inference, the characteristics of the other asset's cash flows must be similar to those of the asset being measured. Therefore, the measurer must do the following:

- (a) Identify the set of cash flows that will be discounted;
- (b) Identify another asset in the marketplace that appears to have similar cash flow characteristics;
- (c) Compare the cash flow sets from the two items to ensure that they are similar (for example, are both sets contractual cash flows, or is one contractual and the other an estimated cash flow?);
- (d) Evaluate whether there is an element in one item that is not present in the other (for example, is one less liquid than the other?); and
- (e) Evaluate whether both sets of cash flows are likely to behave (i.e., vary) in a similar fashion in changing economic conditions.

Expected Cash Flow Approach

AG7. The expected cash flow approach is, in some situations, a more effective measurement tool than the traditional approach. In developing a measurement, the expected cash flow approach uses all expectations about possible cash flows instead of the single most likely cash flow. For example, a cash flow might be CU100,¹ CU200, or CU300, with probabilities of 10 percent, 60 percent and 30 percent, respectively. The expected cash flow is CU220. The expected cash flow approach thus differs from the traditional approach by focusing on direct analysis of the cash flows in question and on more explicit statements of the assumptions used in the measurement.

AG8. The expected cash flow approach also allows use of present value techniques when the timing of cash flows is uncertain. For example, a cash flow of CU1,000 may be received in one year, two years, or three years, with probabilities of 10 percent, 60 percent, and 30 percent, respectively. The example below shows the computation of expected present value in that situation.

Present value of CU1,000 in 1 year at 5%	CU952.38	
Probability	<u>10 %</u>	CU95.24
Present value of CU1,000 in 2 years at 5.25%	CU902.73	
Probability	<u>60 %</u>	CU541.64
Present value of CU1,000 in 3 years at 5.50%	CU851.61	
Probability	<u>30 %</u>	CU255.48
Expected present value		<u>CU892.36</u>

¹ In this and other examples monetary amounts are denominated in currency units (CU).

- AG9. The expected present value of CU892.36 differs from the traditional notion of a best estimate of CU902.73 (the 60 percent probability). A traditional present value computation applied to this example requires a decision about which of the possible timings of cash flows to use and, accordingly, which would not reflect the probabilities of other timings. This is because the discount rate in a traditional present value computation cannot reflect uncertainties in timing.
- AG10. The use of probabilities is an essential element of the expected cash flow approach. Some question whether assigning probabilities to highly subjective estimates suggests greater precision than, in fact, exists. However, the proper application of the traditional approach (as described in paragraph A6) requires the same estimates and subjectivity without providing the computational transparency of the expected cash flow approach.
- AG11. Many estimates developed in current practice already incorporate the elements of expected cash flows informally. In addition, accountants often face the need to measure an asset using limited information about the probabilities of possible cash flows. For example, an accountant might be confronted with the following situations:
- (a) The estimated amount falls somewhere between CU50 and CU250, but no amount in the range is more likely than any other amount. Based on that limited information, the estimated expected cash flow is CU150 $[(50+250)/2]$;
 - (b) The estimated amount falls somewhere between CU50 and CU250, and the most likely amount is CU100. However, the probabilities attached to each amount are unknown. Based on that limited information, the estimated expected cash flow is CU133.33 $[(50+100+250)/3]$; or
 - (c) The estimated amount will be CU50 (10 percent probability), CU250 (30 percent probability), or CU100 (60 percent probability). Based on that limited information, the estimated expected cash flow is CU140 $[(50 \times 0.10)+(250 \times 0.30)+(100 \times 0.60)]$. In each case, the estimated expected cash flow is likely to provide a better estimate of value in use than the minimum, most likely, or maximum amount taken alone.
- AG12. The application of an expected cash flow approach is subject to a cost-benefit constraint. In some cases, an entity may have access to extensive data and may be able to develop many cash flow scenarios. In other cases, an entity may not be able to develop more than general statements about the variability of cash flows without incurring substantial cost. The entity needs to balance the cost of obtaining additional information against the additional reliability that information will bring to the measurement.

- AG13. Some maintain that expected cash flow techniques are inappropriate for measuring a single item or an item with a limited number of possible outcomes. They offer an example of an asset with two possible outcomes: a 90 percent probability that the cash flow will be CU10 and a 10 percent probability that the cash flow will be CU1,000. They observe that the expected cash flow in that example is CU109, and criticize that result as not representing either of the amounts that may ultimately be paid.
- AG14. Assertions like the one just outlined reflect underlying disagreement with the measurement objective. If the objective is accumulation of costs to be incurred, expected cash flows may not produce a representationally faithful estimate of the expected cost. However, this Standard is concerned with measuring the recoverable amount of an asset. The recoverable amount of the asset in this example is not likely to be CU10, even though that is the most likely cash flow. This is because a measurement of CU10 does not incorporate the uncertainty of the cash flow in the measurement of the asset. Instead, the uncertain cash flow is presented as if it were a certain cash flow. No rational entity would sell an asset with these characteristics for CU10.

Discount Rate

- AG15. Whichever approach an entity adopts for measuring the value in use of an asset, interest rates used to discount cash flows should not reflect risks for which the estimated cash flows have been adjusted. Otherwise, the effect of some assumptions will be double-counted.
- AG16. When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. The purpose is to estimate, as far as possible, a market assessment of:
- (a) The time value of money for the periods until the end of the asset's useful life; and
 - (b) Factors (b), (d) and (e) described in paragraph AG1, to the extent those factors have not caused adjustments in arriving at estimated cash flows.
- AG17. As a starting point in making such an estimate, the entity might take into account the following rates:
- (a) The entity's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model;
 - (b) The entity's incremental borrowing rate; and
 - (c) Other market borrowing rates.

AG18. However, these rates must be adjusted:

- (a) To reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows; and
- (b) To exclude risks that are not relevant to the asset's estimated cash flows or for which the estimated cash flows have been adjusted. Consideration should be given to risks such as country risk, currency risk, and price risk.

AG19. The discount rate is independent of the entity's capital structure and the way the entity financed the purchase of the asset, because the future cash flows expected to arise from an asset do not depend on the way in which the entity financed the purchase of the asset.

AG20. Paragraph 68 requires the discount rate used to be a pre-tax rate. Therefore, when the basis used to estimate the discount rate is post-tax, that basis is adjusted to reflect a pre-tax rate.

AG21. An entity normally uses a single discount rate for the estimate of an asset's value in use. However, an entity uses separate discount rates for different future periods where value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.

Appendix B

Amendments to Other IPSASs

IPSAS 21, *Impairment of Non-Cash-Generating Assets*, is amended as follows (deleted text is struck through and new text is underlined)

Paragraphs 5 and 6 are amended:

5. Public sector entities that hold cash-generating assets as defined in paragraph 14 shall apply ~~International Accounting Standard IAS 36, “Impairment of Assets”~~ IPSAS 26, *Impairment of Cash-Generating Assets* to such assets. Public sector entities that hold non-cash-generating assets shall apply the requirements of this Standard to non-cash-generating assets.
6. This Standard excludes from its scope the impairment of assets that are dealt with in another International Public Sector Accounting Standard. GBEs apply IAS 36, *Impairment of Assets* and therefore are not subject to the provisions of this Standard. Public sector entities other than GBEs apply ~~IAS 36~~ IPSAS 26 to their cash-generating assets and apply this Standard to their non-cash-generating assets. Paragraphs 6 to 13 explain the scope of this Standard in greater detail.

Paragraph 14 is amended:

Cash-generating assets are assets held ~~to generate~~ with the primary objective of generating a commercial return.

Paragraph 16 is deleted:

- ~~16. Cash-generating assets are those that are held to generate a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Holding an asset to generate a “commercial return” indicates that an entity intends to generate positive cash inflows from the asset (or of the unit of which the asset is a part) and earn a return that reflects the risk involved in holding the asset.~~

The following paragraphs are added:

16. Cash-generating assets are assets held with the primary objective of generating a commercial return. An asset generates a commercial return when it is deployed in a manner consistent with that adopted by a profit-oriented entity. Holding an asset to generate a “commercial return” indicates that an entity intends to generate positive cash inflows from the asset (or from the cash-generating unit of which the asset is a part) and earn a commercial return that reflects the risk involved in holding the asset. An asset may be held with the primary objective of generating a commercial return even though it does not meet that objective during a particular reporting period. Conversely, an

asset may be a non-cash-generating asset even though it may be breaking even or generating a commercial return during a particular reporting period. Unless stated otherwise, references to “an asset” or “assets” in the following paragraphs of this Standard are references to “non-cash-generating asset(s).

17. There are a number of circumstances in which public sector entities may hold some assets with the primary objective of generating a commercial return, although the majority of assets are not held for that purpose. For example, a hospital may deploy a building for fee-paying patients. Cash-generating assets of a public sector entity may operate independently of the non-cash-generating assets of the entity. For example, the deeds office may earn land registration fees independently from the department of land affairs.
18. In certain instances, an asset may generate cash flows although it is primarily held for service delivery purposes. For example, a waste disposal plant is operated to ensure the safe disposal of medical waste generated by state controlled hospitals, but the plant also treats a small amount of medical waste generated by other private hospitals on a commercial basis. The treatment of medical waste from the private hospitals is incidental to the activities of the plant, and the assets that generate cash flows cannot be distinguished from the non-cash-generating assets.
19. In other instances, an asset may generate cash flows and also be used for non-cash-generating purposes. For example, a public hospital has ten wards, nine of which are used for fee-paying patients on a commercial basis, and the other is used for non-fee paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 26, *Impairment of Cash-Generating Assets*. If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies IPSAS 26 rather than this Standard.
20. In some cases it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases it is necessary to evaluate the significance of the cash flows. It may be difficult to determine whether the extent to which the asset generates cash flows is so significant that this Standard is applicable rather than IPSAS 26. Judgment is needed to determine which Standard to apply. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets and with the related guidance in paragraphs 16A–16E. Paragraph 67B requires an entity to disclose the criteria used in making this judgment. However, given the overall objectives of most public sector entities, other than GBES, the presumption is that assets are non-cash-generating and, therefore, IPSAS 21 will apply.

Paragraph 71 is redesignated as black letter:

71. The redesignation of assets from cash-generating assets to non-cash-generating assets or from non-cash-generating assets to cash-generating assets shall only occur when there is clear evidence that such a redesignation is appropriate. A redesignation, by itself, does not necessarily trigger an impairment test or a reversal of an impairment loss. Instead, the indication for an impairment test or a reversal of an impairment loss arises from, as a minimum, the listed indications applicable to the asset after redesignation.

The following paragraphs are added:

72. There are circumstances in which public sector entities may decide that it is appropriate to redesignate a non-cash-generating asset as a cash-generating asset. For example, an effluent treatment plant was constructed primarily to treat industrial effluent from a social housing unit, for which no charge is made. The social housing unit has been demolished and the site will be developed for industrial and retail purposes. It is intended that, in future, the plant will be used to treat industrial effluent at commercial rates. In light of this decision the public sector entity decides to redesignate the effluent treatment plant as a cash-generating asset.

- 72A. An entity shall disclose the criteria developed by the entity to distinguish non-cash-generating assets from cash-generating assets.**

In the Basis for Conclusions the following paragraphs are amended:

- BC5. IAS 36 requires an entity to determine value in use as the present value of estimated future cash flows expected to be derived from the continuing use of the asset, or cash-generating unit, and from its disposal at the end of its useful life. The service potential of cash-generating assets is reflected by their ability to generate future cash flows. IPSAS 26 is based on IAS 36. The requirements of ~~IAS 36~~ IPSAS 26 are applicable to cash-generating assets held by public sector entities. This Standard requires entities to apply ~~IAS 36~~ IPSAS 26 to account for the impairment of cash-generating assets in the public sector.

In the Basis for Conclusions the following paragraph is deleted:

- ~~C20 This Standard requires the impairment of cash-generating assets to be dealt with under IAS 36. IAS 36 applies to property, plant and equipment carried at revalued amounts. Therefore, this Standard does not exempt cash-generating property, plant and equipment carried at revalued amounts from an impairment test.~~

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 26.

Development of IPSAS 26 based on the IASB's revised version of IAS 36 issued in 2004

Introduction

- BC1. The IPSASB's IFRS Convergence Program is an important element in the IPSASB's work program. The IPSASB's policy is to converge the accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.
- BC2. The IPSASB issued IPSAS 21, *Impairment of Non-Cash-Generating Assets*, in December 2004. IPSAS 21 prescribes the procedures that an entity applies to determine whether a non-cash-generating asset is impaired, and establishes how the impairment is recognized and measured. The majority of assets in the public sector are non-cash-generating, and the recognition and measurement requirements developed resulted in a number of differences in IPSAS 21 from International Accounting Standard, IAS 36, *Impairment of Assets*.

Need for this Standard

- BC3. IPSAS 21 referred readers to IAS 36 (a) in order to establish whether cash-generating assets have been impaired, and (b) for accounting for the recognition and measurement of any impairment. There are benefits in incorporating requirements and guidance on the impairment of cash-generating assets in an IPSAS, so that public sector entities do not have to refer to IAS 36 when an entity has cash-generating assets. In addition, there are a number of public sector issues related to impairment. These include:
- (a) Whether cash-generating property, plant, and equipment carried in accordance with the revaluation model in IPSAS 17, *Property, Plant, and Equipment* should be within the scope;
 - (b) Distinguishing cash-generating and non-cash-generating assets;
 - (c) The redesignation of cash-generating assets to non-cash-generating assets and vice-versa; and
 - (d) The treatment for impairment purposes of non-cash-generating assets in cash-generating units.

Exclusion of Property, Plant, and Equipment Carried at Revalued Amounts and Intangible Assets that are Regularly Revalued to Fair Value from Scope

- BC4. The scope of IPSAS 21 excludes non cash-generating property, plant, and equipment carried at revalued amounts in accordance with the revaluation

model in IPSAS 17. The Basis for Conclusions in IPSAS 21 states that the IPSASB is of the view that assets carried at revalued amounts in accordance with the revaluation model in IPSAS 17 will be revalued with sufficient regularity to ensure (a) that they are carried at an amount that is not materially different from their fair value at the reporting date, and (b) that any impairment will be taken into account in that valuation. The IPSASB therefore considered whether a similar scope exclusion should be included in this Standard.

- BC5. The IPSASB acknowledged that property, plant, and equipment held on the revaluation model are within the scope of IAS 36, and considered the view that guidance on determining impairment losses for such assets would be appropriate for public sector entities with assets on the revaluation model. The IPSASB noted that in IAS 36, in cases where the fair value of an item of property, plant and equipment is its market value, the maximum amount of an impairment loss is the disposal costs. In the Basis for Conclusions for IPSAS 21, it is stated that “the IPSASB is of the view that, in most cases, these will not be material and, from a practical viewpoint, it is not necessary to measure an asset’s recoverable service amount and to recognize an impairment loss for the disposal costs of a non-cash-generating asset.” The IPSASB considered that disposal costs are also unlikely to be material for cash-generating assets.
- BC6. For specialized cash-generating assets where fair value has not been derived from market value, IAS 36 requires recoverability to be estimated through the value in use. Because value in use is based on cash flow projection, it might be materially greater or lower than carrying amount. This analysis is also relevant in the public sector. However, it is questionable whether public sector entities hold specialized assets that meet the definition of a cash-generating asset in this Standard.
- BC7. The IPSASB remains of the view that it would be onerous to impose a requirement to test for impairment in addition to the existing requirement in IPSAS 17, i.e., that assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date. Therefore, on balance, the IPSASB concluded that consistency with IPSAS 21 should take precedence over convergence with IAS 36, and that property, plant and equipment carried on the revaluation model in IPSAS 17 should be excluded from the scope of this Standard. Consistent with the approach to property, plant, and equipment, intangible assets that are regularly revalued to fair value are also excluded from the scope.

Exclusion of Goodwill from Scope

- BC8. IAS 36 contains extensive requirements and guidance on (a) the impairment of goodwill, (b) the allocation of goodwill to cash-generating units, and (c)

testing cash-generating units with goodwill for impairment. The IPSASB considered whether goodwill should be within the scope of this Standard. The IPSASB has not yet issued an IPSAS dealing with entity combinations and considers it likely that a number of public sector-specific issues will arise when combinations of public sector entities take place: in particular, whether an acquirer can always be identified in combinations of public sector entities. The IPSASB concluded that goodwill should not be within the scope of this Standard. In accordance with the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, users are referred to the requirements of the relevant international or national accounting standards dealing with the impairment of goodwill, the allocation of goodwill to cash-generating units, and the testing for impairment of cash-generating units with goodwill.

Distinguishing Cash-Generating and Non-Cash-Generating Assets

BC9. The IPSASB noted that some assets have both cash-generating and non-cash-generating characteristics. The IPSASB considered whether it should adopt a components-based approach that would identify the cash-generating and non-cash-generating components of assets and subject them to different treatments. The IPSASB rejected such an approach because of cost-benefit considerations. The IPSASB concluded that assets in the public sector are generally non-cash-generating, and that an analysis of their service potential is the preferred basis to determine impairment. This Standard therefore includes a rebuttable presumption at paragraph 18 that assets that are both cash-generating and non-cash-generating should be treated as non-cash-generating assets.

Indications of Impairment: Market Capitalization

BC10. The IPSASB considered whether the indications for impairment of cash-generating assets held by public sector entities – both external sources and internal sources of information – are similar to those in IAS 36. The IPSASB concluded that the indications in IAS 36 are relevant, except for the indication that the carrying amount of the net assets of the entity is more than its market capitalization. The IPSASB is of the view that very few public sector entities that are not GBEs will issue equity instruments traded in deep markets, and that such an indication will therefore only be relevant on the consolidation of GBEs.

Fair Value less Costs to Sell and Forced Sales

BC11. In commentary on the definition of “fair value less costs to sell,” IAS 36 states that “fair value less costs to sell does not reflect a forced sale,” but includes a qualification: “unless management is compelled to sell immediately.” IPSAS 26 does not include this qualification in paragraph 40 because there are very few circumstances in which public sector entities that

are not GBEs will be forced to sell immediately in order to remain a going concern.

Redesignation of Assets

BC12. Cash-generating assets can become non-cash-generating assets and vice-versa. The IPSASB considered under what circumstances a redesignation of an asset from cash-generating to non-cash-generating and vice-versa should be permitted. The IPSASB concluded that a redesignation can occur only when there is clear evidence that it is appropriate. The IPSASB also concluded that a redesignation by itself does not trigger an impairment test or the reversal of an impairment loss. Instead, at the subsequent reporting date, an entity should evaluate the appropriate indicators following redesignation to determine if a test is needed. These requirements are stated in paragraph 112.

Cash-Generating Units

BC13. As in IAS 36, where it is not possible to determine the recoverable amount for an individual asset, then the recoverable amount for the asset's cash-generating unit (CGU) will be determined. The CGU is the smallest identifiable group of assets (a) that generates cash inflows from continuing use, and (b) that is largely independent of the cash inflows from other assets or groups of assets. The IPSASB concluded that the notion of a CGU is appropriate for cash-generating assets in a public sector context.

Corporate Assets

BC14. IAS 36 includes requirements related to corporate assets. Corporate assets are defined in IAS 36 as “assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units”—that is, a corporate asset contributes only to CGUs and not to non-cash-generating activities. The IPSASB considered whether this Standard should include requirements for corporate assets as defined in IAS 36.

BC15. The primary purpose of public sector entities that are not GBEs is not the generation of commercial returns. Therefore, the IPSASB considers that there will be very few occasions in which an asset shared between different activities (such as an administrative building) contributes service potential to CGUs without also contributing service potential to non-cash-generating activities. It was therefore decided that it is not necessary to define, and provide requirements for, corporate assets in this Standard. Paragraph 96 refers entities to the relevant international and national accounting standard dealing with assets that do not generate cash flows independently of other assets and form part of more than one cash-generating unit, but do not contribute service potential to non-cash-generating activities.

Treatment of Non-Cash-Generating Assets in Cash-Generating Units

- BC16. There are likely to be a number of cases in which public sector entities hold non-cash-generating assets that contribute service potential to CGUs in addition to non-cash-generating activities. The IPSASB considered the approach to the treatment of such non-cash-generating assets in CGUs. In particular, the IPSASB considered whether it is appropriate to include a proportion of the carrying amount of a non-cash-generating asset, following any impairment test under IPSAS 21, in the carrying amount of the CGU when comparing the carrying amount of that CGU with its recoverable amount.
- BC17. The IPSASB concluded that a proportion of the carrying amount of such a non-cash-generating asset should be included in the carrying amount of the CGU. That proportion should be determined on a basis pro rata to the service potential that such an asset contributes to the CGU. If the non-cash-generating asset is ignored, the carrying amount of the CGU may be understated and impairment losses not recognized. However, because any impairment of the non-cash-generating asset will have been determined in accordance with IPSAS 21, the non-cash-generating asset will have been written down to its recoverable service amount. Therefore, no further impairment loss relating to the CGU should be applied to the non-cash-generating asset. Any impairment losses are allocated on a pro rata basis, based on carrying values, to the cash-generating assets in the CGU, subject to the limits in paragraph 92. This approach is reflected in paragraph 95.

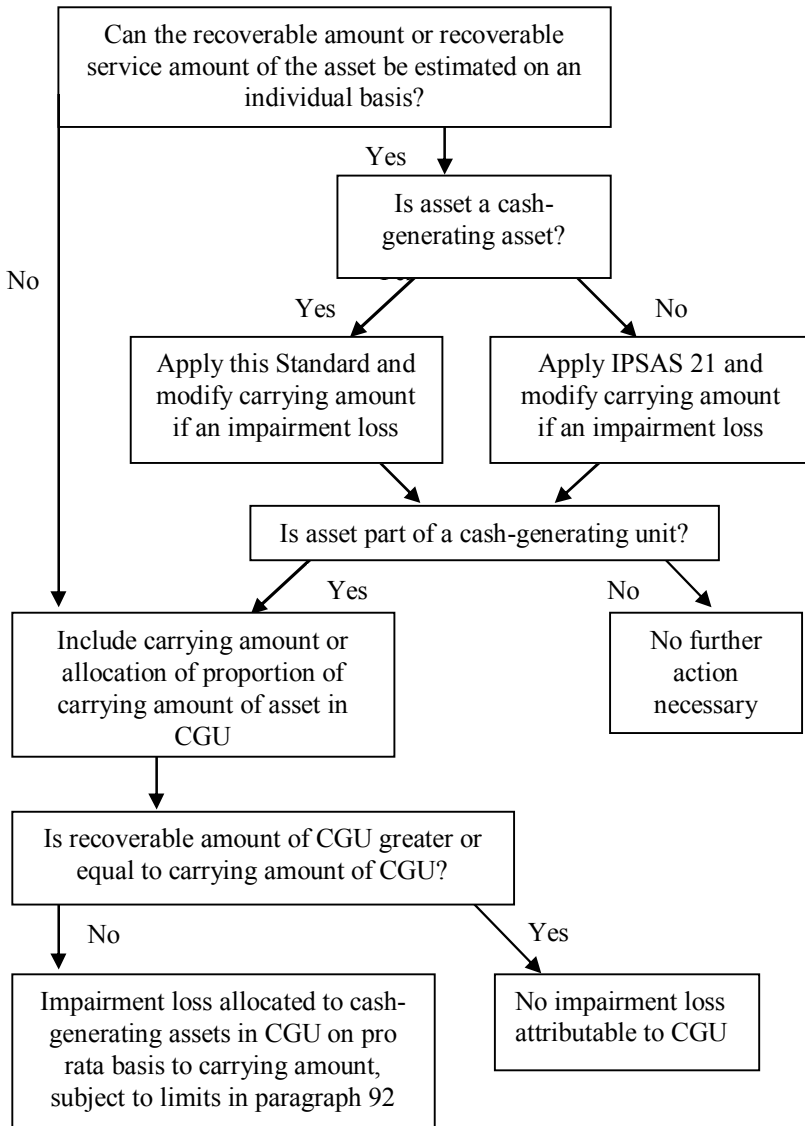
Revision of IPSAS 26 as a result of the IASB's Improvements to IFRSs issued in 2008

- BC18. The IPSASB reviewed the revisions to IAS 36 included in the *Improvements to IFRSs* issued by the IASB in May 2008 and generally concurred with the IASB's reasons for revising the standard. The IPSASB concluded that there was no public sector specific reason for not adopting the amendment.

Illustrative Decision Tree

This decision tree accompanies, but is not part of, IPSAS 26.

For simplicity and clarity, this flowchart assumes that any asset that is part of a CGU also contributes service potential to non-cash-generating activities. When an asset only contributes service potential to one or more CGUs, but not to non-cash-generating activities, entities refer to the relevant international and national accounting standard dealing with such circumstances in accordance with paragraph 96.



Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 26.

Most assets held by public sector entities are non-cash-generating assets, and accounting for their impairment should be undertaken in accordance with IPSAS 21.

In those circumstances when an asset held by a public sector entity is held with the objective of generating a commercial return, the provisions of this Standard should be followed. Most cash-generating assets will arise in business activities run by government agencies that do not meet the definition of a GBE. An example is a seed-producing unit run on a commercial basis that is part of an agricultural research entity.

For the purposes of all these examples, a public sector entity that is not a GBE undertakes commercial activities.

Identification of Cash-Generating Units

The purpose of this example is:

- (a) *To indicate how cash-generating units are identified in various situations; and*
- (b) *To highlight certain factors that an entity may consider in identifying the cash-generating unit to which an asset belongs.*

A—Reduction in Demand Related to a Single-Product Unit

Background

IG1. A government has an electricity-generating utility. The utility has two turbine generators in a single electric plant. In the current period, a major manufacturing plant in the area closed and demand for power was significantly reduced. In response, the government shut down one of the generators.

Analysis

IG2. The individual turbine generators do not generate cash flows in and of themselves. Therefore the cash-generating unit to be used in determining an impairment is the electric plant as a whole.

B—Government Air Freight Unit that Leases an Aircraft

Background

IG3. M is the air freight unit of a government entity. It operates three aircraft, a landing strip, and a number of hangers and other buildings, including maintenance and fueling facilities. Because of declining demand for its services, M leases one aircraft for a five-year period to a private sector entity.

Under the terms of the lease, M is required to allow the lessee to use the landing strip and is responsible for all maintenance to the aircraft.

Analysis

- IG4. Because of the terms of the lease, the leased aircraft cannot be considered to generate cash inflows that are largely independent of the cash inflows from M as a whole. Therefore, it is likely that the cash-generating unit to which the aircraft belongs is M as a whole.

C—Crushing Plant in Waste Disposal Entity

Background

- IG5. A municipality runs a waste disposal entity that owns a crushing plant to support its waste disposal activities. The crushing plant could be sold only for scrap value, and it does not generate cash inflows that are largely independent of the cash inflows from the other assets of the waste disposal entity.

Analysis

- IG6. It is not possible to estimate the recoverable amount of the crushing plant, because its value in use cannot be determined and is probably different from the scrap value. Therefore, the entity estimates the recoverable amount of the cash-generating unit to which the crushing plant belongs, i.e., the waste disposal entity as a whole.

D—Routes Provided by Bus Company

Background

- IG7. A state bus company provides services under contract with a municipality that specifies minimum service on each of five separate routes. Assets devoted to each route and the cash flows from each route can be identified separately. One of the routes operates at a significant loss.

Analysis

- IG8. Because the entity does not have the option to curtail any one bus route, the lowest level of identifiable cash inflows that are largely independent of the cash inflows from other assets or groups of assets is the cash inflows generated by the five routes together. The cash-generating unit is the bus company as a whole.

Calculation of Value in Use and Recognition of an Impairment Loss

Background and Calculation of Value in Use

- IG9. At the beginning of 20X0, Government R, through its Department of Power, puts into service a power plant that it constructed for CU250 million.

- IG10. At the beginning of 20X4, power plants constructed by competitors are put into service, resulting in a reduction in the revenues produced by the power plant of Government R. Reductions in revenue result because the volume of electricity generated has decreased from expectations, and also because the prices for electricity and stand-by capacity have decreased from expectations.
- IG11. The reduction in revenue is evidence that the economic performance of the asset is worse than expected. Consequently, Government R is required to determine the asset's recoverable amount.
- IG12. Government R uses straight-line depreciation over a 20-year life for the power plant and anticipates no residual value.
- IG13. It is not possible to determine the fair value less costs to sell of the power plant. Therefore, recoverability can only be determined through the calculation of value in use. To determine the value in use for the power plant (see Schedule 1), Government R:
- (a) Prepares cash flow forecasts derived from the most recent financial budgets/forecasts for the next five years (years 20X5-20X9) approved by management;
 - (b) Estimates subsequent cash flows (years 20Y0-20Y9) based on declining growth rates ranging from -6 percent per annum to -3 percent per annum; and
 - (c) Selects a 6 percent discount rate, which represents a rate that reflects current market assessments of the time value of money and the risks specific to Government R's power plant.

Recognition and Measurement of Impairment Loss

- IG14. The recoverable amount of Government R's power plant is CU121.1 million.
- IG15. Government R compares the recoverable amount of the power plant to its carrying amount (see Schedule 2).
- IG16. Because the carrying amount exceeds the recoverable amount by CU78.9 million, an impairment loss of CU78.9 million is recognized immediately in surplus or deficit.

Schedule 1—Calculation of the Value in Use of Government R's Power Plant at the End of 20X4

Year	Long-term growth rates	Future cash flows	Present value factor at 6% discount rate [§]	Discounted future cash flows (CUm)
20X5 (n=1)		16.8 *	0.94340	15.8
20X6		14.4 *	0.89000	12.8
20X7		14.2 *	0.83962	11.9
20X8		14.1 *	0.79209	11.2
20X9		13.9 *	0.74726	10.4
20Y0	(6%)	13.1 †	0.70496	9.2
20Y1	(6%)	12.3 †	0.66506	8.2
20Y2	(6%)	11.6 †	0.62741	7.3
20Y3	(5%)	11.0 †	0.59190	6.5
20Y4	(5%)	10.5 †	0.55839	5.9
20Y5	(5%)	10.0 †	0.52679	5.3
20Y6	(4%)	9.6 †	0.49697	4.8
20Y7	(4%)	9.2 †	0.46884	4.3
20Y8	(3%)	8.9 †	0.44230	3.9
20Y9	(3%)	8.6 †	0.41727	3.6
Value in use				121.1

* Based on management's best estimate of net cash flow projections.

† Based on an extrapolation from preceding year cash flow using declining growth rates.

§ The present value factor is calculated as $k = 1/(1+a)^n$, where a = discount rate and n = period discount.

Schedule 2—Calculation of the Impairment Loss for Government R's Power Plant at the Beginning of 20X5

Beginning of 20X5	Total CU(m)
Historical cost	250.0
Accumulated depreciation (20X4)	(50.0)
Carrying amount	200.0
Carrying amount after impairment loss	121.1
Impairment loss	(78.9)

Reversal of an Impairment Loss

This Example relies on the data for Government R as presented in Example 2, with supplementary information provided in this Example. In this Example, tax effects are ignored.

Background

- IG17. By 20X6 some competitors have closed down power plants and this has meant that the negative impact on the revenues of Government R has been less than projected at the end of 2004. This favorable change requires the government to re-estimate the recoverable amount of the power plant.
- IG18. Calculations similar to those in Example 2 show that the recoverable amount of the power plant is now CU157.7 million.

Reversal of Impairment Loss

- IG19. Government R compares the recoverable amount and the net carrying amount of the power plant and reverses part of the impairment loss previously recognized at Example 2.

Non-Cash-Generating Asset that Contributes to a Cash-Generating Unit

Background

- IG20. A public hospital owns and operates a Magnetic Resonance Imaging (MRI) scanner that is primarily used by wards for non-fee paying patients. However, 20% of its usage is for treatment of fee-paying patients. The fee-paying patients are accommodated and treated in a separate building that includes wards, an operating theatre, and numerous pieces of capital equipment used solely for fee-paying patients. At December 31, 20X6, the carrying value of the building and capital equipment is CU30,000. It is not possible to estimate the recoverable amount of the building and the items of capital equipment on an individual basis. Therefore, the building and capital equipment are considered as a cash-generating unit (CGU). At January 1, 20X6 the MRI scanner had a carrying value of CU3,000. A depreciation expense of CU600 is recognized for the MRI scanner at December 31, 20X6. Because there have been significant technological advances in the field, the MRI scanner is tested for impairment at December 31, 20X6 and an impairment loss of CU400 is determined, so that the carrying value of the MRI scanner at December 31, 20X6 is CU2,000.

Determination of Recoverable Amount of Cash-Generating Unit

- IG21. During the year there had been a significant reduction in the number of fee-paying patients at the hospital. The CGU is therefore tested for impairment. The recoverable amount of the CGU, based on its value in use, is assessed as CU27,400. 20% of the revised carrying value of the MRI scanner (CU400) is allocated to the carrying amount of the CGU before determining the impairment loss (CU3,000). The impairment loss is allocated to the building and capital equipment pro rata based on their carrying values. No further impairment loss is allocated to the MRI scanner, as an impairment loss has

already been determined under the requirements of IPSAS 21, *Impairment of Non-Cash-Generating Assets*.

Inclusion of Recognized Liabilities in Calculation of Recoverable Amount of a Cash-Generating Unit

Background

IG22. A municipality operates a waste disposal site and is required to restore the site on completion of its operations. The cost of restoration includes the replacement of the topsoil, which must be removed before waste disposal operations commence. A provision for the costs to replace the top soil was recognized as soon as the top soil was removed. The amount provided was recognized as part of the cost of the site and is being depreciated over the site's useful life. The carrying amount of the provision for restoration costs is CU500, which is equal to the present value of the restoration costs.

Impairment Testing

IG23. The municipality is testing the site for impairment. The cash-generating unit is the site as a whole. The government has received various offers to buy the site at a price of around CU800. This price reflects the fact that the buyer will assume the obligation to restore the topsoil. Disposal costs for the site are negligible. The value in use of the site is approximately CU1,200, excluding restoration costs. The carrying amount of the waste disposal site is CU1,000.

IG24. The cash-generating unit's fair value less costs to sell is CU800. This amount includes restoration costs that have already been provided for. As a consequence, the value in use for the cash-generating unit is determined after consideration of the restoration costs, and is estimated to be CU700 (CU1,200 minus CU500). The carrying amount of the cash-generating unit is CU500, which is the carrying amount of the site (CU1,000) minus the carrying amount of the provision for restoration costs (CU500). Therefore, the recoverable amount of the cash-generating unit exceeds its carrying amount.

Accounting Treatment of an Individual Asset in a Cash-Generating Unit dependent on whether Recoverable Amount can be Determined

Background

IG25. A holding tank at a water purification plant has suffered physical damage but is still working, although not as well as before it was damaged. The holding tank's fair value less costs to sell is less than its carrying amount. The holding tank does not generate independent cash inflows. The smallest identifiable group of assets that includes the holding tank and generates cash inflows that are largely independent of the cash inflows from other assets is the plant to which the holding tank belongs. The recoverable amount of the plant shows that the plant taken as a whole is not impaired.

Recoverable Amount of Holding Tank Cannot be Determined

IG26. Assumption 1: Budgets/forecasts approved by management reflect no commitment of management to replace the holding tank.

IG27. The recoverable amount of the holding tank alone cannot be estimated because the holding tank's value in use:

- (a) May differ from its fair value less costs to sell; and
- (b) Can be determined only for the cash-generating unit to which the holding tank belongs (the water purification plant).

The plant is not impaired. Therefore, no impairment loss is recognized for the holding tank. Nevertheless, the entity may need to reassess the depreciation period or the depreciation method for the holding tank. Perhaps a shorter depreciation period or a faster depreciation method is required to reflect the expected remaining useful life of the holding tank or the pattern in which economic benefits are expected to be consumed by the entity.

Recoverable Amount of Holding Tank Can be Determined

IG28. Assumption 2: Budgets/forecasts approved by management reflect a commitment of management to replace the holding tank and sell it in the near future. Cash flows from continuing use of the holding tank until its disposal are estimated to be negligible.

IG29. The holding tank's value in use can be estimated to be close to its fair value less costs to sell. Therefore, the recoverable amount of the holding tank can be determined, and no consideration is given to the cash-generating unit to which the holding tank belongs (i.e., the production line). Because the holding tank's fair value less costs to sell is below its carrying amount, an impairment loss is recognized for the holding tank.

Comparison with IAS 36

IPSAS 26, *Impairment of Cash-Generating Assets* deals with the impairment of cash-generating assets in the public sector, and includes an amendment made to IAS 36 (2004), *Impairment of Assets* as part of the *Improvements to IFRSs* issued in May 2008. The main differences between IPSAS 26 and IAS 36 are as follows: The main differences between IPSAS 26 and IAS 36 are as follows:

- IPSAS 26 does not apply to cash-generating assets carried at revalued amounts at the reporting date under the revaluation model in IPSAS 17, *Property, Plant, and Equipment*. IAS 36 does not exclude from its scope cash-generating property, plant, and equipment carried at revalued amounts at the reporting date.
- IPSAS 26 does not apply to intangible assets that are regularly revalued to fair value. IAS 36 does not exclude from its scope intangible assets that are regularly revalued to fair value.
- Goodwill is outside the scope of IPSAS 26. IAS 36 includes extensive requirements and guidance on the impairment of goodwill, the allocation of goodwill to cash-generating units, and testing cash-generating units with goodwill for impairment.
- IPSAS 26 defines cash-generating assets and includes additional commentary to distinguish cash-generating assets and non-cash-generating assets.
- The definition of a cash-generating unit in IPSAS 26 is modified from that in IAS 36.
- IPSAS 26 does not include a definition of corporate assets or requirements relating to such assets. IAS 36 includes a definition of corporate assets and requirements and guidance on their treatment.
- IPSAS 26 does not treat the fact that the carrying amount of the net assets of an entity is more than the entity's market capitalization as indicating impairment. The fact that the carrying amount of the net assets is more than the entity's market capitalization is treated by IAS 36 as part of the minimum set of indications of impairment.
- In IPSAS 26, a forced sale is not a reflection of fair value less costs to sell. In IAS 36, a forced sale is a reflection of fair value less costs to sell, if management is compelled to sell immediately.
- IPSAS 26 includes requirements and guidance on the treatment of non-cash-generating assets that contribute to cash-generating units as well as to non-cash-generating activities. IAS 36 does not deal with non-cash-generating assets that contribute to cash-generating units as well as to non-cash-generating activities.

- IPSAS 26 includes requirements and guidance dealing with the redesignation of assets from cash-generating to non-cash-generating and non-cash-generating to cash-generating. IPSAS 26 also requires entities to disclose the criteria developed to distinguish cash-generating assets from non-cash-generating assets. There are no equivalent requirements in IAS 36.
- IPSAS 26 uses different terminology, in certain instances, from IAS 36. The most significant examples are the use of the terms “revenue” and “statement of financial performance.” The equivalent terms in IAS 36 are “income” and “income statement.”

IPSAS 27—AGRICULTURE

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 41, *Agriculture* published by the International Accounting Standards Board (IASB). Extracts from IAS 41 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IFRSs, IASs, Exposure Drafts, and other publications of the IASB are copyright of the IFRS Foundation.

“IFRS,” “IAS,” “IASB,” “IFRS Foundation,” “International Accounting Standards,” and “International Financial Reporting Standards” are trademarks of the IFRS Foundation and should not be used without the approval of the IFRS Foundation.

IPSAS 27—AGRICULTURE

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 15, 2014.

IPSAS 27, *Agriculture* was issued in December 2009.

Since then, IPSAS 27 has been amended by the following IPSASs:

- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 27

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011

IPSAS 27—AGRICULTURE**CONTENTS**

	Paragraph
Objective	1
Scope	2–8
Definitions	9–12
Agriculture-related Definitions	9–11
General Definitions	12
Recognition and Measurement	13–37
Gains and Losses	30–33
Inability to Measure Fair Value Reliably	34–37
Disclosure	38–54
General	38–51
Additional Disclosures for Biological Assets Where Fair Value Cannot Be Measured Reliably	52–54
Transitional Provision	55
Initial Adoption of Accrual Accounting	55
Effective Date	56–57
Appendix: Amendments to Other IPSASs	
Basis for Conclusions	
Illustrative Examples	
Comparison with IAS 41	

International Public Sector Accounting Standard 27, *Agriculture* is set out in paragraphs 1–57. All the paragraphs have equal authority. IPSAS 27 should be read in the context of its objective, the Basis for Conclusions and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment and disclosures for agricultural activity.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard for the following when they relate to agricultural activity:**
 - (a) **Biological assets; and**
 - (b) **Agricultural produce at the point of harvest.**
3. This Standard does not apply to:
 - (a) Land related to agricultural activity (see IPSAS 16, *Investment Property* and IPSAS 17, *Property, Plant, and Equipment*);
 - (b) Intangible assets related to agricultural activity (see IPSAS 31, *Intangible Assets*); and
 - (c) Biological assets held for the provision or supply of services.
4. Biological assets are used in many activities undertaken by public sector entities. When biological assets are used for research, education, transportation, entertainment, recreation, customs control or in any other activities that are not agricultural activities as defined in paragraph 9 of this Standard, those biological assets are not accounted for in accordance with this Standard. Where those biological assets meet the definition of an asset, other IPSASs should be considered in determining the appropriate accounting (e.g., IPSAS 12, *Inventories* and IPSAS 17).
5. This Standard is applied to agricultural produce, which is the harvested product of the entity's biological assets, only at the point of harvest. Thereafter, IPSAS 12, or another applicable Standard, is applied. Accordingly, this Standard does not deal with the processing of agricultural produce after harvest; for example, the processing of grapes into wine by a vintner who has grown the grapes. While such processing may be a logical and natural extension of agricultural activity, and the events taking place may bear some similarity to biological transformation, such processing is not included within the definition of agricultural activity in this Standard.
6. The table below provides examples of biological assets, agricultural produce, and products that are the result of processing after harvest:

Biological assets	Agricultural produce	Products that are the result of processing after harvest
Sheep	Wool	Yarn, carpet
Trees in a plantation forest	Felled trees	Logs, lumber
Plants	Cotton	Thread, clothing
	Harvested cane	Sugar
Dairy cattle	Milk	Cheese
Pigs	Carcass	Sausages, cured hams
Bushes	Leaf	Tea, cured tobacco
Vines	Grapes	Wine
Fruit trees	Picked fruit	Processed fruit

7. **This Standard applies to all public sector entities other than Government Business Enterprises.**
8. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

Definitions

Agriculture-related Definitions

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

Agricultural activity is the management by an entity of the biological transformation and harvest of biological assets for:

- Sale;
- Distribution at no charge or for a nominal charge; or
- Conversion into agricultural produce or into additional biological assets for sale or for distribution at no charge or for a nominal charge.

Agricultural produce is the harvested product of the entity's biological assets.

A biological asset is a living animal or plant.

Biological transformation comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.

Costs to sell are the incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. Disposal may occur through sale or through distribution at no charge or for a nominal charge.

A group of biological assets is an aggregation of similar living animals or plants.

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

10. Agricultural activity covers a diverse range of activities; for example, raising livestock, forestry, annual or perennial cropping, cultivating orchards and plantations, floriculture, and aquaculture (including fish farming). Certain common features exist within this diversity:
 - (a) *Capability to change.* Living animals and plants are capable of biological transformation;
 - (b) *Management of change.* Management facilitates biological transformation by enhancing, or at least stabilizing, conditions necessary for the process to take place (for example, nutrient levels, moisture, temperature, fertility, and light). Such management distinguishes agricultural activity from other activities. For example, harvesting from unmanaged sources (such as ocean fishing and deforestation) is not agricultural activity; and
 - (c) *Measurement of change.* The change in quality (for example, genetic merit, density, ripeness, fat cover, protein content, and fiber strength) or quantity (for example, progeny, weight, cubic meters, fiber length or diameter, and number of buds) brought about by biological transformation or harvest is measured and monitored as a routine management function.
11. Biological transformation results in the following types of outcomes:
 - (a) Asset changes through (i) growth (an increase in quantity or improvement in quality of an animal or plant), (ii) degeneration (a decrease in the quantity or deterioration in quality of an animal or plant), or (iii) procreation (creation of additional living animals or plants); or
 - (b) Production of agricultural produce such as latex, tea leaf, wool, and milk.

General Definitions

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

Recognition and Measurement

13. **An entity shall recognize a biological asset or agricultural produce when and only when:**
 - (a) **The entity controls the asset as a result of past events;**
 - (b) **It is probable that future economic benefits or service potential associated with the asset will flow to the entity; and**
 - (c) **The fair value or cost of the asset can be measured reliably.**
14. The fair value of an asset is based on its present location and condition. As a result, for example, the fair value of cattle at a farm is the price for the cattle in the relevant market less the transport and other costs of getting the cattle either to that market or to the location where it will be distributed at no charge or for a nominal charge.
15. In agricultural activity, control may be evidenced by, for example, legal ownership of cattle and the branding or otherwise marking of the cattle on acquisition, birth, or weaning. The future benefits or service potential are normally assessed by measuring the significant physical attributes.
16. **A biological asset shall be measured on initial recognition and at each reporting date at its fair value less costs to sell, except for the case described in paragraph 34 where the fair value cannot be measured reliably.**
17. **Where an entity acquires a biological asset through a non-exchange transaction, the biological asset is measured on initial recognition and at each reporting date in accordance with paragraph 16.**
18. **Agricultural produce harvested from an entity's biological assets shall be measured at its fair value less costs to sell at the point of harvest. Such measurement is the cost at that date when applying IPSAS 12, or another applicable Standard.**
19. The determination of fair value for a biological asset or agricultural produce may be facilitated by grouping biological assets or agricultural produce according to significant attributes; for example, by age or quality. An entity selects the attributes corresponding to the attributes used in the market as a basis for pricing.
20. Entities often enter into contracts to sell their biological assets or agricultural produce at a future date. Contract prices are not necessarily relevant in determining fair value, because fair value reflects the current market in which a willing buyer and seller would enter into a transaction. As a result, the fair value of a biological asset or agricultural produce is not adjusted because of the existence of a contract. In some cases, a contract for the sale of a biological asset or agricultural produce in an exchange transaction may be an

onerous contract, as defined in IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. IPSAS 19 applies to onerous contracts.

21. If an active market exists for a biological asset or agricultural produce in its present location and condition, the quoted price in that market is the appropriate basis for determining the fair value of that asset. If an entity has access to different active markets, the entity uses the most relevant one. For example, if an entity has access to two active markets, it would use the price existing in the market expected to be used.
22. If an active market does not exist, an entity uses one or more of the following, when available, in determining fair value:
 - (a) The most recent market transaction price, provided that there has not been a significant change in economic circumstances between the date of that transaction and the reporting date;
 - (b) Market prices for similar assets with adjustment to reflect differences; and
 - (c) Sector benchmarks such as the value of an orchard expressed per export tray, bushel, or hectare, and the value of cattle expressed per kilogram of meat.
23. In some cases, the information sources listed in paragraph 22 may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An entity considers the reasons for those differences, in order to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.
24. In some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances, an entity uses the present value of expected net cash flows from the asset discounted at a current market-determined rate in determining fair value.
25. The objective of a calculation of the present value of expected net cash flows is to determine the fair value of a biological asset in its present location and condition. An entity considers this in determining an appropriate discount rate to be used and in estimating expected net cash flows. In determining the present value of expected net cash flows, an entity includes the net cash flows that market participants would expect the asset to generate in its most relevant market.
26. An entity does not include any cash flows for financing the assets, taxation, or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).
27. In agreeing an arm's length transaction price, knowledgeable, willing buyers and sellers consider the possibility of variations in cash flows. It follows that fair value reflects the possibility of such variations. Accordingly, an entity

incorporates expectations about possible variations in cash flows into either the expected cash flows, or the discount rate, or some combination of the two. In determining a discount rate, an entity uses assumptions consistent with those used in estimating the expected cash flows, to avoid the effect of some assumptions being double-counted or ignored.

28. Cost may sometimes approximate fair value, particularly when:
 - (a) Little biological transformation has taken place since initial cost incurrence (for example, for fruit tree seedlings planted immediately prior to reporting date); or
 - (b) The impact of the biological transformation on price is not expected to be material (for example, for the initial growth in a 30-year pine plantation production cycle).
29. Biological assets are often physically attached to land (for example, trees in a plantation forest). There may be no separate market for biological assets that are attached to the land but an active market may exist for the combined assets, that is, for the biological assets, raw land, and land improvements, as a package. An entity may use information regarding the combined assets to determine fair value for the biological assets. For example, the fair value of raw land and land improvements may be deducted from the fair value of the combined assets to arrive at the fair value of biological assets.

Gains and Losses

30. **A gain or loss arising on initial recognition of a biological asset at fair value less costs to sell and from a change in fair value less costs to sell of a biological asset shall be included in surplus or deficit for the period in which it arises.**
31. A loss may arise on initial recognition of a biological asset, because costs to sell are deducted in determining fair value less costs to sell of a biological asset. A gain may arise on initial recognition of a biological asset, such as when a calf is born.
32. **A gain or loss arising on initial recognition of agricultural produce at fair value less costs to sell shall be included in surplus or deficit for the period in which it arises.**
33. A gain or loss may arise on initial recognition of agricultural produce as a result of harvesting.

Inability to Measure Fair Value Reliably

34. **There is a presumption that fair value can be measured reliably for a biological asset. However, that presumption can be rebutted only on initial recognition for a biological asset for which market-determined prices or values are not available, and for which alternative estimates of**

fair value are determined to be clearly unreliable. In such a case, that biological asset shall be measured at its cost less any accumulated depreciation and any accumulated impairment losses. Once the fair value of such a biological asset becomes reliably measurable, an entity shall measure it at its fair value less costs to sell. Once a non-current biological asset meets the criteria to be classified as held for sale (or is included in a disposal group that is classified as held for sale) in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations, it is presumed that fair value can be measured reliably.

35. The presumption in paragraph 34 can be rebutted only on initial recognition. An entity that has previously measured a biological asset at its fair value less costs to sell continues to measure the biological asset at its fair value less costs to sell until disposal.
36. In all cases, an entity measures agricultural produce at the point of harvest at its fair value less costs to sell. This Standard reflects the view that the fair value of agricultural produce at the point of harvest can always be measured reliably.
37. In determining cost, accumulated depreciation and accumulated impairment losses, an entity considers IPSAS 12, IPSAS 17, IPSAS 21, *Impairment of Non-Cash-Generating Assets*, and IPSAS 26, *Impairment of Cash-Generating Assets*.

Disclosure

General

38. **An entity shall disclose the aggregate gain or loss arising during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less costs to sell of biological assets.**
39. **An entity shall provide a description of biological assets that distinguishes between consumable and bearer biological assets and between biological assets held for sale and those held for distribution at no charge or for a nominal charge.**
40. Consumable biological assets are those that are held for harvest as agricultural produce or for sale or distribution at no charge or for a nominal charge as biological assets. Examples of consumable biological assets are animals and plants for one-time use, such as livestock intended for the production of meat, livestock held for sale, fish in farms, crops such as maize and wheat, and trees being grown for lumber. Bearer biological assets are those biological assets that are used repeatedly or continuously for more than one year in an agricultural activity. Bearer biological assets are not agricultural produce but,

rather, are self-regenerating. Examples of types of animals that are bearer biological assets include breeding stocks (including fish and poultry), livestock from which milk is produced, and sheep or other animals used for wool production. Examples of types of plants that are bearer biological assets include trees, vines and shrubs cultivated for fruits, nuts, sap, resin, bark and leaf products and trees from which firewood is harvested while the tree remains.

41. The disclosures required by paragraph 39 would take the form of a quantified description. The quantified description may be accompanied by a narrative description.
42. In making the disclosures required by paragraph 39, an entity is also encouraged to distinguish between mature and immature biological assets, as appropriate. These distinctions provide information that may be helpful in assessing the timing of future cash flows and service potential. An entity discloses the basis for making any such distinctions.
43. Mature biological assets are those that have attained harvestable specifications (for consumable biological assets) or are able to sustain regular harvests (for bearer biological assets).
44. **If not disclosed elsewhere in information published with the financial statements, an entity shall describe:**
 - (a) **The nature of its activities involving each group of biological assets; and**
 - (b) **Non-financial measures or estimates of the physical quantities of:**
 - (i) **Each group of the entity's biological assets at the end of the period; and**
 - (ii) **Output of agricultural produce during the period.**
45. **An entity shall disclose the methods and significant assumptions applied in determining the fair value of each group of agricultural produce at the point of harvest and each group of biological assets.**
46. **An entity shall disclose the fair value less costs to sell of agricultural produce harvested during the period, determined at the point of harvest.**
47. **An entity shall disclose:**
 - (a) **The existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities;**
 - (b) **The nature and extent of restrictions on the entity's use or capacity to sell biological assets;**

- (c) **The amount of commitments for the development or acquisition of biological assets; and**
 - (d) **Financial risk management strategies related to agricultural activity.**
48. **An entity shall present a reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. The reconciliation shall include:**
- (a) **The gain or loss arising from changes in fair value less costs to sell, disclosed separately for bearer biological assets and consumable biological assets;**
 - (b) **Increases due to purchases;**
 - (c) **Increases due to assets acquired through a non-exchange transaction;**
 - (d) **Decreases attributable to sales and biological assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with the relevant international or national standard dealing with non-current assets held for sale and discontinued operations;**
 - (e) **Decreases due to distributions at no charge or for a nominal charge;**
 - (f) **Decreases due to harvest;**
 - (g) **Increases resulting from entity combinations;**
 - (h) **Net exchange differences arising on the translation of financial statements into a different presentation currency, and on the translation of a foreign operation into the presentation currency of the reporting entity; and**
 - (i) **Other changes.**
49. The fair value less costs to sell of a biological asset can change due to both physical changes and price changes in the market. Separate disclosure of physical and price changes is useful in appraising current period performance and future prospects, particularly when there is a production cycle of more than one year. In such cases, an entity is encouraged to disclose, by group or otherwise, the amount of change in fair value less costs to sell included in surplus or deficit due to physical changes and due to price changes. This information is generally less useful when the production cycle is less than one year (for example, when raising chickens or growing cereal crops).
50. Biological transformation results in a number of types of physical change—growth, degeneration, production, and procreation, each of which is

observable and measurable. Each of those physical changes has a direct relationship to future economic benefits or service potential. A change in fair value of a biological asset due to harvesting is also a physical change.

51. Agricultural activity is often exposed to climatic, disease and other natural risks. If an event occurs that gives rise to a material item of revenue or expense, the nature and amount of that item are disclosed in accordance with IPSAS 1. Examples of such an event include an outbreak of a virulent disease, a flood, a severe drought or frost, and a plague of insects.

Additional Disclosures for Biological Assets Where Fair Value Cannot Be Measured Reliably

52. **If an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 34) at the end of the period, the entity shall disclose for such biological assets:**
 - (a) A description of the biological assets;
 - (b) An explanation of why fair value cannot be measured reliably;
 - (c) If possible, the range of estimates within which fair value is highly likely to lie;
 - (d) The depreciation method used;
 - (e) The useful lives or the depreciation rates used; and
 - (f) The gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.
53. **If, during the current period, an entity measures biological assets at their cost less any accumulated depreciation and any accumulated impairment losses (see paragraph 34), an entity shall disclose any gain or loss recognized on disposal of such biological assets and the reconciliation required by paragraph 48 shall disclose amounts related to such biological assets separately. In addition, the reconciliation shall include the following amounts included in surplus or deficit related to those biological assets:**
 - (a) Impairment losses;
 - (b) Reversals of impairment losses; and
 - (c) Depreciation.
54. **If the fair value of biological assets previously measured at their cost less any accumulated depreciation and any accumulated impairment losses becomes reliably measurable during the current period, an entity shall disclose for those biological assets:**

- (a) A description of the biological assets;
- (b) An explanation of why fair value has become reliably measurable; and
- (c) The effect of the change.

Transitional Provision

Initial Adoption of Accrual Accounting

55. Where an entity initially recognizes biological assets or agricultural produce on the first-time adoption of the accrual basis of accounting, the entity shall report the effect of the initial recognition of those assets, and that produce as an adjustment to the opening balance of accumulated surpluses or deficits for the period in which this Standard is first adopted.

Effective Date

56. An entity shall apply this Standard for annual financial statements covering periods beginning on or after April 1, 2011. Earlier application is encouraged. If an entity applies this Standard for a period beginning before April 1, 2011, it shall disclose that fact.
57. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Appendix

Amendments to Other IPSASs

The amendments in this appendix shall be applied for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies this Standard for an earlier period, these amendments shall be applied for that earlier period.

IPSAS 9, *Revenue from Exchange Transactions*

Paragraph 10 is amended as follows:

- 10(e) ~~Arising from natural increase in herds, and agriculture and forest products at initial recognition, and from changes in the fair value of, biological assets related to agricultural activity (see IPSAS 27, *Agriculture*); and~~
- 10(eA) Arising from initial recognition of agricultural produce (see IPSAS 27); and

IPSAS 12, *Inventories*

Paragraph 2(c) is amended as follows:

- 2(c) ~~Biological assets related to agricultural activity and agricultural produce at the point of harvest (see the relevant international or national accounting standard dealing with agriculture IPSAS 27, *Agriculture*); and~~

Paragraph 29 is amended as follows:

29. ~~In accordance with the relevant international or national accounting standard dealing with agriculture IPSAS 27 inventories comprising agricultural produce that an entity has harvested from its biological assets may shall be measured on initial recognition at their fair value less ~~estimated point of sale costs to sell~~ at the point of harvest. This is the cost of the inventories at that date for application of this Standard.~~

Paragraph 51A is inserted after paragraph 51 as follows:

- 51A. IPSAS 27 amended paragraph 29. An entity shall apply that amendment for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies IPSAS 27 for a period beginning before April 1, 2011, the amendment shall also be applied for that earlier period.

IPSAS 13, *Leases*

Paragraphs 2(c) and 2(d) are amended as follows:

- 2(c) **Biological assets held by lessees under finance leases (see ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27, Agriculture); or**
- 2(d) **Biological assets provided by lessors under operating leases (see ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27).**

IPSAS 16, *Investment Property*

Paragraph 6 is amended as follows:

- 6(a) **Biological assets related to agricultural activity (see ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27, Agriculture); and**

IPSAS 17, *Property, Plant, and Equipment*

Paragraph 6 is amended as follows:

- 6(a) **Biological assets related to agricultural activity (see ~~the relevant international or national accounting standard dealing with agriculture~~ IPSAS 27, Agriculture); and or**

IPSAS 26, *Impairment of Cash-Generating Assets*

Paragraph 2 is amended as follows:

- 2(j) **Biological assets related to agricultural activity that are measured at fair value less ~~estimated point-of-sale costs to sell~~ (see ~~the relevant international or national accounting standard dealing with agricultural assets~~ IPSAS 27, Agriculture);**

Paragraph 8 is amended as follows:

- 8. **... In addition, this Standard does not apply to biological assets related to agricultural activity that are measured at fair value less ~~certain point-of-sale costs to sell~~ and non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value less costs to sell. IPSAS 27, Agriculture, dealing with biological assets related to agricultural activity, and ~~the relevant international or national accounting standards dealing with non-current assets (or disposal groups) classified as held for sale, contain measurement requirements.~~**

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 27.

Introduction

- BC1. The IPSASB's IFRSs Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to develop accrual-based IPSASs that are convergent with IFRSs issued by the IASB where appropriate for public sector entities.
- BC2. Accrual-basis IPSASs that are converged with IFRSs maintain the requirements, structure, and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the *Comparison with IFRS* included in each IPSAS.

Biological Assets Held for the Provision or Supply of Services

- BC3. The IPSASB acknowledged that in the public sector biological assets are often held for the provision or supply of services. Examples of such biological assets include horses and dogs used for policing purposes and plants and trees in parks and gardens operated for recreational purposes. The IPSASB concluded that such biological assets are not held for use in an agricultural activity because they are not routinely managed for the purpose of measuring and monitoring the change in quality or quantity brought about by biological transformation or harvest, as described in paragraph 10. In order to clarify that such biological assets are not dealt with in this Standard the IPSASB decided to include a scope exclusion in paragraph 3(c) stating that the Standard does not apply to biological assets held for the provision or supply of services. Paragraph 4 provides examples of such scope exclusions.

Definition of Agricultural Activity

- BC4. In certain jurisdictions biological assets that are part of agricultural activity may be sold or distributed to other public sector entities, non-governmental organizations or other entities at no charge or for a nominal charge. While IAS 41, *Agriculture*, from which this Standard is drawn, deals with commercial agricultural activity, the IPSASB concluded that biological assets held for distribution at no charge or for a nominal charge should be within the definition of agricultural activity, because such transactions are common in the public sector. The IPSASB therefore modified the definition from that in IAS 41 to include references to biological assets held for distribution at no charge or for a nominal charge.

Government Grants

- BC5. IAS 41 specifies requirements and guidance for accounting for government grants related to biological assets that differ from the requirements in IAS 20, *Accounting for Government Grants and Disclosure of Government Assistance*. IPSAS 27 does not include requirements and guidance for government grants, because IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* provides requirements and guidance related to government grants in non-exchange transactions. The IPSASB did not consider that accounting for government grants related to biological assets should vary from the requirements of IPSAS 23.

Biological Assets and Agricultural Assets Acquired through a Non-Exchange Transaction

- BC6. An entity may acquire a biological asset or agricultural produce in a non-exchange transaction. In accordance with this Standard, these assets would be measured at fair value less costs to sell. IPSAS 23 prescribes that assets acquired through a non-exchange transaction should be measured initially at fair value as at the date of acquisition. As a result of the different measurement requirements, the IPSASB considered the appropriate measurement basis for biological assets acquired in a non-exchange transaction.
- BC7. The IPSASB debated various approaches to measuring biological assets and agricultural produce acquired through a non-exchange transaction. In particular, it considered the following three approaches:
- (a) Approach 1: Measure all biological assets and agricultural produce acquired in a non-exchange transaction using IPSAS 23 (i.e., exclude all biological assets and agricultural produce acquired in a non-exchange transaction from the measurement requirements of this Standard);
 - (b) Approach 2: Measure all biological assets and agricultural produce acquired in a non-exchange transaction using this Standard (i.e., exclude all biological assets and agricultural produce from the measurement requirements of IPSAS 23); and
 - (c) Approach 3: Use both IPSAS 23 and this Standard to measure biological assets and agricultural produce acquired in a non-exchange transaction.
- BC8. The IPSASB rejected approach 1 because biological assets and agricultural produce acquired in exchange and non-exchange transactions would be measured differently. The IPSASB agreed that there is no reason to measure biological assets and agricultural produce acquired in a non-exchange transaction differently from those acquired in an exchange transaction because the assets are the same.

- BC9. In analyzing approach 3, the IPSASB considered the requirements of IPSAS 23 in relation to the measurement of other types of assets. IPSAS 23.13 states that: "...If a reporting entity is required to pay delivery and installation costs in relation to the transfer of an item of plant to it from another entity, those costs are recognized separately from revenue arising from the transfer of the item of plant. Delivery and installation costs are included in the amount recognized as an asset, in accordance with IPSAS 17." This implies that for other assets, an entity considers the measurement requirements of other IPSASs as well as IPSAS 23 in initially measuring assets acquired through a non-exchange transaction.
- BC10. An additional attribute relevant to the measurement of biological assets is costs to sell. The IPSASB therefore concluded that in accordance with approach 3, an entity considers the requirements of both IPSAS 23 and this Standard in measuring biological assets and agricultural produce acquired in a non-exchange transaction at fair value less costs to sell at their initial recognition. The IPSASB noted that this is the same outcome as under approach 2.

Biological Assets and Agricultural Produce to be Distributed at No Charge or for a Nominal Charge

- BC11. IAS 41 addresses only biological assets and agricultural produce that will be sold. In the public sector, such assets may be managed with the objective of distributing them at no charge or for a nominal charge. Some respondents to Exposure Draft 36, *Agriculture* expressed a view that a distinction should be made between the recognition and measurement of biological assets held for sale in an exchange transaction, and biological assets held for distribution at no charge or for a nominal charge. The principle was established in IPSAS 12, *Inventories*, that inventories held for distribution at no charge or for a nominal charge should be measured at the lower of cost and current replacement cost. Cost is not an available option in this Standard unless the exception in paragraph 34 applies. Current replacement cost is defined as the cost an entity would incur to acquire the asset at the reporting date, which is an approximation of fair value less costs to sell. Accordingly, the approach in Exposure Draft 36 was not changed.
- BC12. Some respondents to the Exposure Draft also questioned whether gains and losses arising from use of fair value measurement should be reported in the statement of financial performance during the transformation process. The IPSASB is of the view that the gains and losses arising from fair value measurement should be reported in the statement of financial performance because such reporting provides useful accountability information during the biological transformation process. Entities may decide to make additional disclosures to explain the impact of these reported fair value changes.

Disclosure

BC13. The IPSASB considered whether any further disclosures were justified to address public sector specific issues and added disclosure requirements to:

- (a) Distinguish between consumable and bearer biological assets. This distinction is necessary because the Government Finance Statistics (GFS) Manual 2001 (GFSM 2001) classifies consumable assets as inventory, while this Standard classifies them as biological assets. The distinction allows for a better reconciliation between an entity's financial statements prepared under IPSASs and statistical measures.
- (b) Distinguish between biological assets held for sale and those held for distribution at no charge or for a nominal charge. The IPSASB believes this distinction is necessary to permit users to determine the unrealized gains and losses on biological assets held for distribution at no charge or for a nominal charge.
- (c) Show biological assets acquired through non-exchange transactions and biological assets held for distribution at no charge or for a nominal charge in its reconciliation of changes in the carrying amount of biological assets between the beginning and the end of the current period. This disclosure is required to provide appropriate information about non-exchange transactions, which are included in the scope of this Standard.
- (d) Disclose separately the changes in fair value less costs to sell as a result of non-exchange transactions for biological assets held for sale and for biological assets held for distribution at no charge or for a nominal charge. It is important that information is provided on the amount of gains and losses attributable to biological assets intended for distribution at no charge or for a nominal charge to assist users of financial statements in assessing the cost of government programs.
- (e) Describe the nature and extent of restrictions imposed on the entity's use or capacity to sell biological assets, such as the total and restricted amounts of such assets. The IPSASB is of the view that such disclosure provides useful information about the entity's ability to sell agricultural produce at fair value, and thus about its measurement.

Transitional Provisions

BC14. IAS 41 does not contain transitional provisions for first-time adoption of the accrual basis of accounting. This Standard contains such provisions to assist entities in applying this Standard when first adopting the accrual basis of accounting.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 27.

Extracts from statements of financial performance and statements of financial position are provided to show the effects of the transactions described below. These extracts do not necessarily conform to all the disclosure and presentation requirements of other Standards.

The first example illustrates how the disclosure requirements of this Standard might be put into practice for a dairy farming entity. This Standard encourages the separation of the change in fair value less costs to sell of an entity's biological assets into physical change and price change. That separation is reflected in the first example. The second example illustrates how to separate physical change and price change.

Disclosure Requirements

Statement of Financial Position

Entity XYZ	Notes	December 31, 20X8 Currency Unit (CU)	December 31, 20X7 CU
ASSETS			
Current assets			
Cash		10,000	10,000
Receivables		88,000	65,000
Inventories		82,950	70,650
Total current assets		180,950	145,650
Non-current assets			
Bearer biological assets			
Dairy livestock – immature ¹		52,060	47,730
Dairy livestock – mature ¹		372,990	411,840
Subtotal – bearer biological assets	3	425,050	459,570
Property, plant and equipment		1,462,650	1,409,800
Total non-current assets		1,887,700	1,869,370
Total assets		2,068,650	2,015,020
LIABILITIES			
Current liabilities			
Payables		122,628	150,020
Total current liabilities		122,628	150,020
NET ASSETS/EQUITY			
Contributed capital		1,000,000	1,000,000
Accumulated surplus		946,022	865,000
Total net assets/equity		1,946,022	1,865,000
Total net assets/equity and liabilities		2,068,650	2,015,020

¹ An entity is required to provide a description of biological assets that distinguishes between consumable and bearer biological assets and between those held for sale and those held for distribution at no charge or for a nominal charge. Such disclosures would take the form of a quantified description that may be accompanied by a narrative description. An entity is also encouraged, but not required, to distinguish between mature and immature biological assets, as appropriate. An entity discloses the basis for making any such distinctions. This example shows the disclosure of bearer biological assets on the face of the statement of financial position. Information to meet other disclosure requirements is disclosed in the notes to the financial statements, as permitted.

Statement of Financial Performance

		CU
Entity XYZ	Notes	Year ended December 31, 20X8
Fair value of milk produced		518,240
Gains arising from changes in fair value less costs to sell of dairy livestock held for sale	3	39,930
		558,170
Inventories used		(137,523)
Staff costs		(127,283)
Depreciation expense		(15,250)
Other operating expenses		(197,092)
		(477,148)
Surplus for the period		81,022

Statement of Changes in Net Assets/Equity

	Year ended December 31, 20X8		
	CU	CU	CU
	Contributed Capital	Accumulated Surplus	Total
Balance at January 1, 20X8	1,000,000	865,000	1,865,000
Surplus for the period	-	81,022	81,022
Balance at December 31, 20X8	1,000,000	946,022	1,946,022

Cash Flow Statement²

Entity XYZ	Year ended December 31, 20X8
	CU
Cash flows from operating activities	
Cash receipts from sales of milk	498,027
Cash receipts from sales of livestock	97,913
Cash paid for supplies and to employees	(504,025)
Cash paid for purchases of livestock	(23,815)
Net cash from operating activities	68,100
Cash flows from investing activities	
Purchase of property, plant and equipment	(68,100)
Net cash used in investing activities	(68,100)
Net increase in cash	0
Cash at beginning of the year	10,000
Cash at end of the year	10,000

Notes

1. Operations and Principal Activities

Entity XYZ (“the Entity”) is engaged in milk production. At December 31, 20X8, the Entity held 419 cows able to produce milk (mature bearer assets) and 137 heifers being raised to produce milk in the future (immature bearer assets). The Entity produced 157,584kg of milk with a fair value less costs to sell of CU518,240 (the fair value of this agricultural produce is determined at the time of milking) in the year ended December 31, 20X8. The Entity does not own any consumable biological assets.

2. Accounting Policies

Livestock and Milk

Livestock are measured at their fair value less costs to sell. The fair value of livestock is determined based on market prices of livestock of similar age, breed, and genetic merit. Milk is initially measured at its fair value less costs to sell at the time of milking. The fair value of milk is determined based on market prices in the local area.

² This statement of cash flows reports cash flows from operating activities using the direct method. IPSAS 2, “Cash Flow Statements” requires that an entity reports cash flows from operating activities using either the direct method or the indirect method. IPSAS 2 encourages use of the direct method.

3. Biological Assets

	20X8
Reconciliation of Carrying Amounts of Dairy Livestock	CU
Carrying amount at January 1, 20X8	459,570
Increases due to purchases	26,250
Gain arising from changes in fair value less costs to sell attributable to physical changes ³	15,350
Gain arising from changes in fair value less costs to sell attributable to price changes ⁴	24,580
Decreases due to sales	(100,700)
Carrying amount at December 31, 20X8	425,050

4. Financial Risk Management Strategies

The Entity is exposed to financial risks arising from changes in milk prices. The Entity does not anticipate that milk prices will decline significantly in the foreseeable future and, therefore, has not entered into derivative or other contracts to manage the risk of a decline in milk prices. The Entity reviews its outlook for milk prices regularly in considering the need for active financial risk management.

Physical Change and Price Change

The following example illustrates how to separate physical change and price change. Separating the change in fair value less costs to sell between the portion attributable to physical changes and the portion attributable to price changes is encouraged but not required by this Standard.

A herd of ten 2 year old animals was held at January 1, 20X8. One animal aged 2.5 years was purchased on July 1, 20X8 for CU108, and one animal was born on July 1, 20X8. No animals were sold or disposed of during the period. Per-unit fair values less costs to sell were as follows:

	CU	CU
2 year old animal at January 1, 20X8	100	
Newborn animal at July 1, 20X8	70	
2.5 year old animal at July 1, 20X8	108	
Newborn animal at December 31, 20X8	72	
0.5 year old animal at December 31, 20X8	80	
2 year old animal at December 31, 20X8	105	
2.5 year old animal at December 31, 20X8	111	
3 year old animal at December 31, 20X8	120	

³ Separating the increase in fair value less costs to sell between the portion attributable to physical changes and the portion attributable to price changes is encouraged but not required by this Standard.

⁴ See Footnote 3.

Fair value less costs to sell of herd at January 1, 20X8 (10 x 100)		1,000	
Purchase on July 1, 20X8 (1 x 108)			108
Increase in fair value less costs to sell due to price change			
$10 \times (105 - 100)$	50		
$1 \times (111 - 108)$	3		
$1 \times (72 - 70)$	2		55
Increase in fair value less costs to sell due to physical change:			
$10 \times (120 - 105)$	150		
$1 \times (120 - 111)$	9		
$1 \times (80 - 72)$	8		
1×70	70		237
Fair value less costs to sell of herd at December 31, 20X8			
11×120	1,320		
1×80	80		1,400

Comparison with IAS 41

IPSAS 27, *Agriculture* is drawn primarily from IAS 41, *Agriculture* (2001), as amended up to December 31, 2008. The main differences between IPSAS 27 and IAS 41 are as follows:

- The definition of “agricultural activity” includes transactions for the distribution of biological assets at no charge or for a nominal charge. IAS 41 does not deal with such transactions.
- The scope section clarifies that biological assets held for the provision or supply of services are not addressed in this Standard. IAS 41 does not include such a clarification.
- IAS 41 includes requirements for government grants relating to biological assets measured at fair value less costs to sell. IPSAS 27 does not include requirements and guidance for government grants, because IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* provides requirements and guidance related to government grants in non-exchange transactions.
- IPSAS 27 contains requirements for the measurement at initial recognition, and at each reporting date, of biological assets acquired through a non-exchange transaction.
- This Standard contains an additional disclosure requirement for biological assets for which the entity’s use or capacity to sell are subject to restrictions.
- This Standard contains a requirement to distinguish between consumable and bearer biological assets and between biological assets held for sale and those held for distribution at no charge or for a nominal charge. Such disclosures would take the form of a quantified description that may be accompanied by a narrative description. IAS 41 encourages, but does not require, entities to provide a quantified description of each group of biological assets, distinguishing between consumable and bearer biological assets, or between mature and immature biological assets, as appropriate.
- This Standard contains transitional provisions on the first-time adoption of accrual accounting. IAS 41 does not include such transitional provisions.
- IPSAS 27 uses different terminology, in certain instances, from IAS 41. The most significant examples are the use of the terms future economic benefits and service potential, surplus or deficit, and statement of financial performance in IPSAS 27. The equivalent terms in IAS 41 are future economic benefits, profit or loss, and statement of comprehensive income.

IPSAS 28—FINANCIAL INSTRUMENTS: PRESENTATION

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 32, *Financial Instruments: Presentation* and International Financial Reporting Interpretations Committee Interpretation 2 (IFRIC 2), *Members' Shares in Co-operative Entities and Similar Instruments* published by the International Accounting Standards Board (IASB). Extracts from IAS 32 and IFRIC 2 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IFRSs, IASs, Exposure Drafts, and other publications of the IASB are copyright of the IFRS Foundation.

“IFRS,” “IAS,” “IASB,” “IFRS Foundation,” “International Accounting Standards,” and “International Financial Reporting Standards” are trademarks of the IFRS Foundation and should not be used without the approval of the IFRS Foundation.

IPSAS 28—FINANCIAL INSTRUMENTS: PRESENTATION

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 15, 2014.

IPSAS 28, *Financial Instruments: Presentation* was issued in January 2010.

Since then, IPSAS 28 has been amended by the following IPSASs:

- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 28

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011

IPSAS 28—FINANCIAL INSTRUMENTS: PRESENTATION

CONTENTS

	Paragraph
Objective	1–2
Scope	3–8
Definitions	9–12
Presentation	13–37
Liabilities and Net Assets/Equity	13–24
Puttable Instruments	15–16
Instruments, or Components of Instruments, that Impose on the Entity an Obligation to Deliver to Another Party a pro rata Share of the Net Assets of the Entity only on Liquidation ...	17–18
Reclassification of Puttable Instruments and Instruments that Impose on the Entity an Obligation to Deliver to Another Party a pro rata Share of the Net Assets of the Entity only on liquidation	19–20
No Contractual Obligation to Deliver Cash or another Financial Asset	21–24
Settlement in the Entity’s Own Equity Instruments	25–29
Contingent Settlement Provisions	30
Settlement Options	31–32
Compound Financial Instruments	33–37
Treasury Shares	38–39
Interest, Dividends or Similar Distributions, Losses, and Gains	40–46
Offsetting a Financial Asset and a Financial Liability	47–55
Transition	56–58
Effective Date	59–61
Withdrawal and Replacement of IPSAS 15 (2001)	62
Appendix A: Application Guidance	
Appendix B: Members’ Shares in Co-operative Entities and Similar Instruments	

Appendix C: Amendments to Other IPSASs

Basis for Conclusions

Illustrative Examples

Comparison with IAS 32

International Public Sector Accounting Standard 28, *Financial Instruments: Presentation*, is set out in paragraphs 1–62. All the paragraphs have equal authority. IPSAS 28 should be read in the context of its objective, the Basis for Conclusions, and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to establish principles for presenting financial instruments as liabilities or net assets/equity and for offsetting financial assets and financial liabilities. It applies to the classification of financial instruments, from the perspective of the issuer, into financial assets, financial liabilities and equity instruments; the classification of related interest, dividends or similar distributions, losses and gains; and the circumstances in which financial assets and financial liabilities should be offset.
2. The principles in this Standard complement the principles for recognizing and measuring financial assets and financial liabilities in IPSAS 29, *Financial Instruments: Recognition and Measurement*, and for disclosing information about them in IPSAS 30, *Financial Instruments: Disclosures*.

Scope (see also paragraphs AG3–AG9)

3. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard to all types of financial instruments except:**
 - (a) **Those interests in controlled entities, associates or joint ventures that are accounted for in accordance with IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates*, or IPSAS 8, *Interests in Joint Ventures*. However, in some cases, IPSAS 6, IPSAS 7, or IPSAS 8 permits an entity to account for an interest in a controlled entity, associate, or joint venture using IPSAS 29; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures.**
 - (b) **Employers' rights and obligations under employee benefit plans, to which IPSAS 25, *Employee Benefits* applies.**
 - (c) **Obligations arising from insurance contracts. However, this Standard applies to:**
 - (i) **Derivatives that are embedded in insurance contracts if IPSAS 29 requires the entity to account for them separately; and**
 - (ii) **Financial guarantee contracts, if the issuer applies IPSAS 29 in recognizing and measuring the contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply that standard in recognizing and measuring them.**

In addition to (i) and (ii) above, an entity may apply this Standard to insurance contracts which involve the transfer of financial risk.

- (d) **Financial instruments that are within the scope of the international or national accounting standard dealing with insurance contracts because they contain a discretionary participation feature. The issuer of these instruments is exempt from applying to these features paragraphs 13–37 and AG49–AG60 of this Standard regarding the distinction between financial liabilities and equity instruments. However, these instruments are subject to all other requirements of this Standard. Furthermore, this Standard applies to derivatives that are embedded in these instruments (see IPSAS 29).**
 - (e) **Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payments applies, except for:**
 - (i) **Contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies; or**
 - (ii) **Paragraphs 38 and 39 of this Standard, which shall be applied to treasury shares purchased, sold, issued, or cancelled in connection with employee share option plans, employee share purchase plans, and all other share-based payment arrangements.**
- 4. This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.**
- 5. There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:**
- (a) **When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;**
 - (b) **When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument, or by exchanging financial**

instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);

- (c) When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
- (d) When the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirements, and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 4 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirement, and accordingly, whether they are within the scope of this Standard.

- 6. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 5(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.
- 7. **This Standard applies to all public sector entities other than Government Business Enterprises.**
- 8. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

Definitions (see also paragraphs AG10–AG48)

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

An equity instrument is any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.

A financial instrument is any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.

A financial asset is any asset that is:

- (a) **Cash;**

- (b) **An equity instrument of another entity;**
- (c) **A contractual right:**
 - (i) **To receive cash or another financial asset from another entity; or**
 - (ii) **To exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or**
- (d) **A contract that will or may be settled in the entity's own equity instruments and is:**
 - (i) **A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or**
 - (ii) **A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.**

A financial liability is any liability that is:

- (a) **A contractual obligation:**
 - (i) **To deliver cash or another financial asset to another entity; or**
 - (ii) **To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or**
- (b) **A contract that will or may be settled in the entity's own equity instruments and is:**
 - (i) **A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or**
 - (ii) **A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset**

for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.

As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.

A puttable instrument is a financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.

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

10. The following terms are defined in paragraph 10 of IPSAS 29 and are used in this Standard with the meaning specified in that Standard.
 - Amortized cost of a financial asset or financial liability;
 - Available-for-sale financial assets;
 - Derecognizing;
 - Derivative;
 - Effective interest method;
 - Financial asset or financial liability at fair value through surplus or deficit;
 - Financial guarantee contract;
 - Firm commitment;
 - Forecast transaction;
 - Hedge effectiveness;
 - Hedged item;
 - Hedging instrument;

- Held-to-maturity investments;
 - Loans and receivables;
 - Regular way purchase or sale; and
 - Transaction costs.
11. In this Standard, “contract” and “contractual” refer to an agreement between two or more parties that has clear economic consequences that the parties have little, if any, discretion to avoid, usually because the agreement is enforceable by law. Contracts, and thus financial instruments, may take a variety of forms and need not be in writing.
 12. In this Standard, “entity” includes public sector entities, individuals, partnerships, incorporated bodies and trusts.

Presentation

Liabilities and Net Assets/Equity (see also paragraphs AG49–AG54)

13. **The issuer of a financial instrument shall classify the instrument, or its component parts, on initial recognition as a financial liability, a financial asset or an equity instrument in accordance with the substance of the contractual arrangement and the definitions of a financial liability, a financial asset and an equity instrument.**
14. When an issuer applies the definitions in paragraph 9 to determine whether a financial instrument is an equity instrument rather than a financial liability, the instrument is an equity instrument if, and only if, both conditions (a) and (b) below are met.
 - (a) The instrument includes no contractual obligation:
 - (i) To deliver cash or another financial asset to another entity; or
 - (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the issuer.
 - (b) If the instrument will or may be settled in the issuer’s own equity instruments, it is:
 - (i) A non-derivative that includes no contractual obligation for the issuer to deliver a variable number of its own equity instruments; or
 - (ii) A derivative that will be settled only by the issuer exchanging a fixed amount of cash or another financial asset for a fixed number of its own equity instruments. For this purpose the issuer’s own equity instruments do not include instruments that have all the features and meet the conditions described in

paragraphs 15 and 16 or paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the issuer's own equity instruments.

A contractual obligation, including one arising from a derivative financial instrument, that will or may result in the future receipt or delivery of the issuer's own equity instruments, but does not meet conditions (a) and (b) above, is not an equity instrument. As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.

Puttable Instruments

15. A puttable financial instrument includes a contractual obligation for the issuer to repurchase or redeem that instrument for cash or another financial asset on exercise of the put. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:
 - (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets that remain after deducting all other claims on its assets. A pro rata share is determined by:
 - (i) Dividing the entity's net assets on liquidation into units of equal amount; and
 - (ii) Multiplying that amount by the number of the units held by the financial instrument holder.
 - (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:
 - (i) Has no priority over other claims to the assets of the entity on liquidation; and
 - (ii) Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.
 - (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments have identical features. For example, they must all be puttable, and the formula or other method used to calculate the repurchase or redemption price is the same for all instruments in that class.
 - (d) Apart from the contractual obligation for the issuer to repurchase or redeem the instrument for cash or another financial asset, the instrument does not include any contractual obligation to deliver cash

or another financial asset to another entity, or to exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity, and it is not a contract that will or may be settled in the entity's own equity instruments as set out in subparagraph (b) of the definition of a financial liability.

- (e) The total expected cash flows attributable to the instrument over the life of the instrument are based substantially on the surplus or deficit, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity over the life of the instrument (excluding any effects of the instrument).
16. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:
- (a) Total cash flows based substantially on the surplus or deficit, the change in the recognized net assets, or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and
 - (b) The effect of substantially restricting or fixing the residual return to the puttable instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 15 that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the puttable instrument as an equity instrument.

Instruments, or Components of Instruments, that Impose on the Entity an Obligation to Deliver to Another Party a pro rata Share of the Net Assets of the Entity only on Liquidation

17. Some financial instruments include a contractual obligation for the issuing entity to deliver to another entity a pro rata share of its net assets only on liquidation. The obligation arises because liquidation either is certain to occur and outside the control of the entity (e.g., a limited life entity) or is uncertain to occur but is at the option of the instrument holder. As an exception to the definition of a financial liability, an instrument that includes such an obligation is classified as an equity instrument if it has all of the following features:
- (a) It entitles the holder to a pro rata share of the entity's net assets in the event of the entity's liquidation. The entity's net assets are those assets

that remain after deducting all other claims on its assets. A pro rata share is determined by:

- (i) Dividing the net assets of the entity on liquidation into units of equal amount; and
 - (ii) Multiplying that amount by the number of the units held by the financial instrument holder.
- (b) The instrument is in the class of instruments that is subordinate to all other classes of instruments. To be in such a class the instrument:
- (i) Has no priority over other claims to the assets of the entity on liquidation; and
 - (ii) Does not need to be converted into another instrument before it is in the class of instruments that is subordinate to all other classes of instruments.
- (c) All financial instruments in the class of instruments that is subordinate to all other classes of instruments must have an identical contractual obligation for the issuing entity to deliver a pro rata share of its net assets on liquidation.
18. For an instrument to be classified as an equity instrument, in addition to the instrument having all the above features, the issuer must have no other financial instrument or contract that has:
- (a) Total cash flows based substantially on the surplus or deficit, the change in the recognized net assets or the change in the fair value of the recognized and unrecognized net assets of the entity (excluding any effects of such instrument or contract); and
 - (b) The effect of substantially restricting or fixing the residual return to the instrument holders.

For the purposes of applying this condition, the entity shall not consider non-financial contracts with a holder of an instrument described in paragraph 17 that have contractual terms and conditions that are similar to the contractual terms and conditions of an equivalent contract that might occur between a non-instrument holder and the issuing entity. If the entity cannot determine that this condition is met, it shall not classify the instrument as an equity instrument.

Reclassification of Puttable Instruments and Instruments that Impose on the Entity an Obligation to Deliver to Another Party a pro rata Share of the Net Assets of the Entity only on Liquidation

19. An entity shall classify a financial instrument as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 from the date

when the instrument has all the features and meets the conditions set out in those paragraphs. An entity shall reclassify a financial instrument from the date when the instrument ceases to have all the features or meet all the conditions set out in those paragraphs. For example, if an entity redeems all its issued non-puttable instruments and any puttable instruments that remain outstanding have all of the features and meet all the conditions in paragraphs 15 and 16, the entity shall reclassify the puttable instruments as equity instruments from the date when it redeems the non-puttable instruments.

20. An entity shall account as follows for the reclassification of an instrument in accordance with paragraph 19:
 - (a) It shall reclassify an equity instrument as a financial liability from the date when the instrument ceases to have all of the features or meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18. The financial liability shall be measured at the instrument's fair value at the date of reclassification. The entity shall recognize in net assets/equity any difference between the carrying value of the equity instrument and the fair value of the financial liability at the date of reclassification.
 - (b) It shall reclassify a financial liability as an equity instrument from the date when the instrument has all of the features and meets the conditions set out in paragraphs 15 and 16 or paragraphs 17 and 18. An equity instrument shall be measured at the carrying value of the financial liability at the date of reclassification.

*No Contractual Obligation to Deliver Cash or Another Financial Asset
(paragraph 14(a))*

21. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, a critical feature in differentiating a financial liability from an equity instrument is the existence of a contractual obligation of one party to the financial instrument (the issuer) either to deliver cash or another financial asset to the other party (the holder) or to exchange financial assets or financial liabilities with the holder under conditions that are potentially unfavorable to the issuer. Although the holder of an equity instrument may be entitled to receive a pro rata share of any dividends or similar distributions declared, or distributions of the net assets/equity, the issuer does not have a contractual obligation to make such distributions because it cannot be required to deliver cash or another financial asset to another party.
22. The substance of a financial instrument, rather than its legal form, governs its classification on the entity's statement of financial position. Substance and legal form are commonly consistent, but not always. Some financial instruments take the legal form of equity instruments but are liabilities in substance and others may combine features associated with equity instruments and features associated with financial liabilities. For example:

- (a) A preference share that provides for mandatory redemption by the issuer for a fixed or determinable amount at a fixed or determinable future date, or gives the holder the right to require the issuer to redeem the instrument at or after a particular date for a fixed or determinable amount, is a financial liability.
- (b) A financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a “puttable instrument”) is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. For example, open-ended mutual funds, unit trusts, partnerships and some co-operative entities may provide their unitholders or members with a right to redeem their interests in the issuer at any time for cash, which results in the unitholders’ or members’ interests being classified as financial liabilities, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. However, classification as a financial liability does not preclude the use of descriptors such as “net asset value attributable to unitholders” and “change in net asset value attributable to unitholders” on the face of the financial statements of an entity that has no contributed net assets/equity (such as some mutual funds and unit trusts, see Illustrative Example 7) or the use of additional disclosure to show that total members’ interests comprise items such as reserves that meet the definition of net assets/equity and puttable instruments that do not (see Illustrative Example 8).

23. If an entity does not have an unconditional right to avoid delivering cash or another financial asset to settle a contractual obligation, the obligation meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. For example:

- (a) A restriction on the ability of an entity to satisfy a contractual obligation, such as lack of access to foreign currency or the need to obtain approval for payment from a regulatory authority, does not negate the entity’s contractual obligation or the holder’s contractual right under the instrument.

- (b) A contractual obligation that is conditional on a counterparty exercising its right to redeem is a financial liability because the entity does not have the unconditional right to avoid delivering cash or another financial asset.
24. A financial instrument that does not explicitly establish a contractual obligation to deliver cash or another financial asset may establish an obligation indirectly through its terms and conditions. For example:
- (a) A financial instrument may contain a non-financial obligation that must be settled if, and only if, the entity fails to make distributions or to redeem the instrument. If the entity can avoid a transfer of cash or another financial asset only by settling the non-financial obligation, the financial instrument is a financial liability.
 - (b) A financial instrument is a financial liability if it provides that on settlement the entity will deliver either:
 - (i) Cash or another financial asset; or
 - (ii) Its own shares whose value is determined to exceed substantially the value of the cash or other financial asset.

Although the entity does not have an explicit contractual obligation to deliver cash or another financial asset, the value of the share settlement alternative is such that the entity will settle in cash. In any event, the holder has in substance been guaranteed receipt of an amount that is at least equal to the cash settlement option (see paragraph 25).

Settlement in the Entity's Own Equity Instruments (paragraph 14(b))

25. A contract is not an equity instrument solely because it may result in the receipt or delivery of the entity's own equity instruments. An entity may have a contractual right or obligation to receive or deliver a number of its own shares or other equity instruments that varies so that the fair value of the entity's own equity instruments to be received or delivered equals the amount of the contractual right or obligation. Such a contractual right or obligation may be for a fixed amount or an amount that fluctuates in part or in full in response to changes in a variable other than the market price of the entity's own equity instruments (e.g., an interest rate, a commodity price, or a financial instrument price). Two examples are (a) a contract to deliver as many of the entity's own equity instruments as are equal in value to CU100, and (b) a contract to deliver as many of the entity's own equity instruments as are equal in value to the value of 100 barrels of oil. Such a contract is a financial liability of the entity even though the entity must or can settle it by delivering its own equity instruments. It is not an equity instrument because the entity uses a variable number of its own equity instruments as a means to

settle the contract. Accordingly, the contract does not evidence a residual interest in the entity's assets after deducting all of its liabilities.

26. Except as stated in paragraph 27, a contract that will be settled by the entity (receiving or) delivering a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument. For example, an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed price or for a fixed stated principal amount of a bond is an equity instrument. Changes in the fair value of a contract arising from variations in market interest rates that do not affect the amount of cash or other financial assets to be paid or received, or the number of equity instruments to be received or delivered, on settlement of the contract do not preclude the contract from being an equity instrument. Any consideration received (such as the premium received for a written option or warrant on the entity's own shares) is added directly to net assets/equity. Any consideration paid (such as the premium paid for a purchased option) is deducted directly from net assets/equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.
27. If the entity's own equity instruments to be received, or delivered, by the entity upon settlement of a contract are puttable financial instruments with all of the features and meeting the conditions described in paragraphs 15 and 16, or instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation with all of the features and meeting the conditions described in paragraphs 17 and 18, the contract is a financial asset or a financial liability. This includes a contract that will be settled by the entity receiving or delivering a fixed number of such instruments in exchange for a fixed amount of cash or another financial asset.
28. With the exception of the circumstances described in paragraphs 15 and 16 or paragraphs 17 and 18, a contract that contains an obligation for an entity to purchase its own equity instruments for cash or another financial asset gives rise to a financial liability for the present value of the redemption amount (e.g., for the present value of the forward repurchase price, option exercise price, or other redemption amount). This is the case even if the contract itself is an equity instrument. One example is an entity's obligation under a forward contract to purchase its own equity instruments for cash. When the financial liability is recognized initially under IPSAS 29, its fair value (the present value of the redemption amount) is reclassified from net assets/equity. Subsequently, the financial liability is measured in accordance with IPSAS 29. If the contract expires without delivery, the carrying amount of the financial liability is reclassified to net assets/equity. An entity's contractual obligation to purchase its own equity instruments gives rise to a financial liability for the present value of the redemption amount even if the obligation to purchase is conditional on the counterparty exercising a right to redeem

(e.g., a written put option that gives the counterparty the right to sell an entity's own equity instruments to the entity for a fixed price).

29. A contract that will be settled by the entity delivering or receiving a fixed number of its own equity instruments in exchange for a variable amount of cash or another financial asset is a financial asset or financial liability. An example is a contract for the entity to deliver 100 of its own equity instruments in return for an amount of cash calculated to equal the value of 100 barrels of oil.

Contingent Settlement Provisions

30. A financial instrument may require the entity to deliver cash or another financial asset, or otherwise to settle it in such a way that it would be a financial liability, in the event of the occurrence or non-occurrence of uncertain future events (or on the outcome of uncertain circumstances) that are beyond the control of both the issuer and the holder of the instrument, such as a change in a stock market index, consumer price index, interest rate, or taxation requirements, or the issuer's future revenues, surplus or deficit, or debt-to-equity ratio. The issuer of such an instrument does not have the unconditional right to avoid delivering cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability). Therefore, it is a financial liability of the issuer unless:
 - (a) The part of the contingent settlement provision that could require settlement in cash or another financial asset (or otherwise in such a way that it would be a financial liability) is not genuine;
 - (b) The issuer can be required to settle the obligation in cash or another financial asset (or otherwise to settle it in such a way that it would be a financial liability) only in the event of liquidation of the issuer; or
 - (c) The instrument has all of the features and meets the conditions in paragraphs 15 and 16.

Settlement Options

31. **When a derivative financial instrument gives one party a choice over how it is settled (e.g., the issuer or the holder can choose settlement net in cash or by exchanging shares for cash), it is a financial asset or a financial liability unless all of the settlement alternatives would result in it being an equity instrument.**
32. An example of a derivative financial instrument with a settlement option that is a financial liability is a share option that the issuer can decide to settle net in cash or by exchanging its own shares for cash. Similarly, some contracts to buy or sell a non-financial item in exchange for the entity's own equity instruments are within the scope of this Standard because they can be settled either by delivery of the non-financial item or net in cash or another financial

instrument (see paragraphs 4–6). Such contracts are financial assets or financial liabilities and not equity instruments.

Compound Financial Instruments (see also paragraphs AG55–AG60 and Illustrative Examples 9–12)

33. **The issuer of a non-derivative financial instrument shall evaluate the terms of the financial instrument to determine whether it contains both a liability component and a net assets/equity component. Such components shall be classified separately as financial liabilities, financial assets, or equity instruments in accordance with paragraph 13.**
34. An entity recognizes separately the components of a financial instrument that (a) creates a financial liability of the entity and (b) grants an option to the holder of the instrument to convert it into an equity instrument of the entity. For example, a bond or similar instrument convertible by the holder into a fixed number of ordinary shares of the entity is a compound financial instrument. From the perspective of the entity, such an instrument comprises two components: a financial liability (a contractual arrangement to deliver cash or another financial asset) and an equity instrument (a call option granting the holder the right, for a specified period of time, to convert it into a fixed number of ordinary shares of the entity). The economic effect of issuing such an instrument is substantially the same as issuing simultaneously a debt instrument with an early settlement provision and warrants to purchase ordinary shares, or issuing a debt instrument with detachable share purchase warrants. Accordingly, in all cases, the entity presents the liability and net assets/equity components separately in its statement of financial position.
35. Classification of a convertible instrument into its components is not revised as a result of a change in the likelihood that a conversion option will be exercised, even when exercise of the option may appear to have become economically advantageous to some holders. Holders may not always act in the way that might be expected because, for example, the tax consequences resulting from conversion may differ among holders. Furthermore, the likelihood of conversion will change from time to time. The entity's contractual obligation to make future payments remains outstanding until it is extinguished through conversion, maturity of the instrument, or some other transaction.
36. IPSAS 29 deals with the measurement of financial assets and financial liabilities. Equity instruments evidence a residual interest in the assets of an entity after deducting all of its liabilities. Therefore, when the initial carrying amount of a compound financial instrument is allocated into its components, the net assets/equity component is assigned the residual amount after deducting from the fair value of the instrument as a whole the amount separately determined for the liability component. The value of any derivative features (such as a call option) embedded in the compound financial

instrument is included in the liability component unless it forms part of the component of net assets/equity (such as an equity conversion option). The sum of the carrying amounts assigned to the liability and the net assets/equity components on initial recognition is always equal to the fair value that would be ascribed to the instrument as a whole. No gain or loss arises from initially recognizing the components of the instrument separately.

37. Under the approach described in paragraph 36, the issuer of a bond convertible into ordinary shares first determines the carrying amount of the liability component by measuring the fair value of a similar liability (including any embedded non-equity derivative features) that does not have an associated net assets/equity component. The carrying amount of the equity instrument represented by the option to convert the instrument into ordinary shares is then determined by deducting the fair value of the financial liability from the fair value of the compound financial instrument as a whole.

Treasury Shares (see also paragraph AG61)

38. **If an entity reacquires its own equity instruments, those instruments (“treasury shares”) shall be deducted from net assets/equity. No gain or loss shall be recognized in surplus or deficit on the purchase, sale, issue, or cancellation of an entity’s own equity instruments. Such treasury shares may be acquired and held by the entity or by other members of the economic entity. Consideration paid or received shall be recognized directly in net assets/equity.**
39. The amount of treasury shares held is disclosed separately either in the statement of financial position or in the notes, in accordance with IPSAS 1. An entity provides disclosure in accordance with IPSAS 20, *Related Party Disclosures* if the entity reacquires its own equity instruments from related parties.

Interest, Dividends or Similar Distributions, Losses, and Gains (see also paragraph AG62)

40. **Interest, dividends or similar distributions, losses, and gains relating to a financial instrument or a component that is a financial liability shall be recognized as revenue or expense in surplus or deficit. Distributions to holders of an equity instrument shall be debited by the entity directly to net assets/equity, net of any related income tax benefit. Transaction costs incurred on transactions in net assets/equity shall be accounted for as a deduction from net assets/equity, net of any related income tax benefit.**
41. The classification of a financial instrument as a financial liability or an equity instrument determines whether interest, dividends or similar distributions, losses, and gains relating to that instrument are recognized as revenue or expense in surplus or deficit. Thus, dividends or similar distributions on shares wholly recognized as liabilities are recognized as expenses in the same

way as interest on a bond. Similarly, gains and losses associated with redemptions or refinancings of financial liabilities are recognized in surplus or deficit, whereas redemptions or refinancings of equity instruments are recognized as changes in net assets/equity. Changes in the fair value of an equity instrument are not recognized in the financial statements.

42. An entity typically incurs various costs in issuing or acquiring its own equity instruments. Those costs might include registration and other regulatory fees, amounts paid to legal, accounting and other professional advisers, printing costs, and stamp duties. Any related transaction costs are accounted for as a deduction from net assets/equity (net of any related income tax benefit) to the extent they are incremental costs directly attributable to the transaction that otherwise would have been avoided. The costs of such a transaction that is abandoned are recognized as an expense.
43. Transaction costs that relate to the issue of a compound financial instrument are allocated to the liability and the net assets/equity components of the instrument in proportion to the allocation of proceeds. Transaction costs that relate jointly to more than one transaction are allocated to those transactions using a basis of allocation that is rational and consistent with similar transactions.
44. The amount of transaction costs accounted for as a deduction from net assets/equity in the period is disclosed separately under IPSAS 1.
45. Dividends or similar distributions classified as an expense are presented in the statement of financial performance either with interest on other liabilities or as a separate item. In addition to the requirements of this Standard, disclosure of interest and dividends or similar distributions is subject to the requirements of IPSAS 1 and IPSAS 30. In some circumstances, because of the differences between interest and dividends or similar distributions with respect to matters such as tax deductibility, it is desirable to disclose them separately in the statement financial performance.
46. Gains and losses related to changes in the carrying amount of a financial liability are recognized as revenue or expense in surplus or deficit even when they relate to an instrument that includes a right to the residual interest in the assets of the entity in exchange for cash or another financial asset (see paragraph 22(b)). Under IPSAS 1 the entity presents any gain or loss arising from remeasurement of such an instrument separately in the statement of financial performance when it is relevant in explaining the entity's performance.

Offsetting a Financial Asset and a Financial Liability (see also paragraphs AG63 and AG64)

47. **A financial asset and a financial liability shall be offset and the net amount presented in the statement of financial position when, and only when, an entity:**
- (a) **Currently has a legally enforceable right to set off the recognized amounts; and**
 - (b) **Intends either to settle on a net basis, or to realize the asset and settle the liability simultaneously.**

In accounting for a transfer of a financial asset that does not qualify for derecognition, the entity shall not offset the transferred asset and the associated liability (see IPSAS 29, paragraph 38).

48. This Standard requires the presentation of financial assets and financial liabilities on a net basis when doing so reflects an entity's expected future cash flows from settling two or more separate financial instruments. When an entity has the right to receive or pay a single net amount and intends to do so, it has, in effect, only a single financial asset or financial liability. In other circumstances, financial assets and financial liabilities are presented separately from each other consistently with their characteristics as resources or obligations of the entity.
49. Offsetting a recognized financial asset and a recognized financial liability and presenting the net amount differs from the derecognition of a financial asset or a financial liability. Although offsetting does not give rise to recognition of a gain or loss, the derecognition of a financial instrument not only results in the removal of the previously recognized item from the statement of financial position but also may result in recognition of a gain or loss.
50. A right of set-off is a debtor's legal right, by contract or otherwise, to settle or otherwise eliminate all or a portion of an amount due to a creditor by applying against that amount an amount due from the creditor. In unusual circumstances, a debtor may have a legal right to apply an amount due from a third party against the amount due to a creditor provided that there is an agreement between the three parties that clearly establishes the debtor's right of set-off. Because the right of set-off is a legal right, the conditions supporting the right may vary from one legal jurisdiction to another and the laws applicable to the relationships between the parties need to be considered.
51. The existence of an enforceable right to set-off a financial asset and a financial liability affects the rights and obligations associated with a financial asset and a financial liability and may affect an entity's exposure to credit and liquidity risk. However, the existence of the right, by itself, is not a sufficient basis for offsetting. In the absence of an intention to exercise the right or to settle simultaneously, the amount and timing of an entity's future cash flows

are not affected. When an entity intends to exercise the right or to settle simultaneously, presentation of the asset and liability on a net basis reflects more appropriately the amounts and timing of the expected future cash flows, as well as the risks to which those cash flows are exposed. An intention by one or both parties to settle on a net basis without the legal right to do so is not sufficient to justify offsetting because the rights and obligations associated with the individual financial asset and financial liability remain unaltered.

52. An entity's intentions with respect to settlement of particular assets and liabilities may be influenced by its normal operating practices, the requirements of the financial markets, and other circumstances that may limit the ability to settle net or to settle simultaneously. When an entity has a right of set-off, but does not intend to settle net or to realize the asset and settle the liability simultaneously, the effect of the right on the entity's credit risk exposure is disclosed in accordance with paragraph 42 of IPSAS 30.
53. Simultaneous settlement of two financial instruments may occur through, for example, the operation of a clearing house in an organized financial market or a face-to-face exchange. In these circumstances the cash flows are, in effect, equivalent to a single net amount and there is no exposure to credit or liquidity risk. In other circumstances, an entity may settle two instruments by receiving and paying separate amounts, becoming exposed to credit risk for the full amount of the asset or liquidity risk for the full amount of the liability. Such risk exposures may be significant even though relatively brief. Accordingly, realization of a financial asset and settlement of a financial liability are treated as simultaneous only when the transactions occur at the same moment.
54. The conditions set out in paragraph 47 are generally not satisfied and offsetting is usually inappropriate when:
 - (a) Several different financial instruments are used to emulate the features of a single financial instrument (a "synthetic instrument");
 - (b) Financial assets and financial liabilities arise from financial instruments having the same primary risk exposure (e.g., assets and liabilities within a portfolio of forward contracts or other derivative instruments) but involve different counterparties;
 - (c) Financial or other assets are pledged as collateral for non-recourse financial liabilities;
 - (d) Financial assets are set aside in trust by a debtor for the purpose of discharging an obligation without those assets having been accepted by the creditor in settlement of the obligation (e.g., a sinking fund arrangement); or

- (e) Obligations incurred as a result of events giving rise to losses are expected to be recovered from a third party by virtue of a claim made under an insurance contract.
55. An entity that undertakes a number of financial instrument transactions with a single counterparty may enter into a “master netting arrangement” with that counterparty. Such an agreement provides for a single net settlement of all financial instruments covered by the agreement in the event of default on, or termination of, any one contract. These arrangements may be commonly used to provide protection against loss in the event of bankruptcy or other circumstances that result in a counterparty being unable to meet its obligations. A master netting arrangement commonly creates a right of set-off that becomes enforceable and affects the realization or settlement of individual financial assets and financial liabilities only following a specified event of default or in other circumstances not expected to arise in the normal course of operations. A master netting arrangement does not provide a basis for offsetting unless both of the criteria in paragraph 47 are satisfied. When financial assets and financial liabilities subject to a master netting arrangement are not offset, the effect of the arrangement on an entity’s exposure to credit risk is disclosed in accordance with paragraph 42 of IPSAS 30.

Transition

56. **An entity shall apply this Standard retrospectively on first time application.**
57. **When an entity that previously applied IPSAS 15, *Financial Instruments: Disclosure and Presentation*, applies the requirements in paragraphs 15 to 18, an entity is required to split a compound financial instrument with an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation into a liability and net assets/equity component. If the liability component is no longer outstanding, a retrospective application of these requirements would involve separating two components of net assets/equity. The first component would be in accumulated surpluses and deficits and represent the cumulative interest accreted on the liability component. The other component would represent the original net assets/equity component. Therefore, an entity need not separate these two components if the liability component is no longer outstanding when the Standard is adopted.**
58. **An entity that either previously did not apply IPSAS 15 or adopts accrual accounting for the first time, applies the transitional provision in paragraph 57 to all compound financial instruments.**

Effective Date

59. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2013, it shall disclose that fact.**
60. **An entity shall not apply this Standard before January 1, 2013, unless it also applies IPSAS 29 and IPSAS 30.**
61. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Withdrawal and Replacement of IPSAS 15 (2001)

62. This Standard and IPSAS 30 supersede IPSAS 15, issued in 2001. IPSAS 15 remains applicable until IPSAS 28 and IPSAS 30 are applied or become effective, whichever is earlier.

Application Guidance

This Appendix is an integral part of IPSAS 28.

- AG1. This Application Guidance explains the application of particular aspects of the Standard.
- AG2. The Standard does not deal with the recognition or measurement of financial instruments. Requirements about the recognition and measurement of financial assets and financial liabilities are set out in IPSAS 29.

Scope (paragraphs 3–6)

Financial Guarantee Contracts

- AG3. Financial guarantee contracts are those contracts that require the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original terms of a debt instrument. Governments may issue financial guarantees for a variety of reasons. They are often issued to further a government's policy objectives, for example, to support infrastructure projects and stabilize the financial market in times of distress. Governments and public sector entities may be granted the power to issue financial guarantees by legislation or other authority. In assessing whether a guarantee is contractual or non-contractual, an entity distinguishes the right to issue the guarantee and the actual issue of the guarantee. The right to issue the guarantee in terms of legislation or other authority is non-contractual, while the actual issue of the guarantee should be assessed using the principles in paragraph AG20 to determine whether the guarantee is contractual.
- AG4. The issuing of financial guarantees in favor of a third party, whether explicitly or implicitly, may result in a contractual arrangement. Financial guarantees may be issued to a specific party or they may be issued to the holder of an instrument. Consider the following two examples:
- In a service concession arrangement, a government may issue a financial guarantee directly to the financiers of the transaction stating that, in the event of default, it would assume payment for any outstanding principal and interest payments of a loan. In this instance, the financial guarantee is explicitly issued in favor of an identified counterparty.
 - Road authority A is responsible for constructing and maintaining a country's road infrastructure. It finances the construction of new roads by issuing long term bonds. National government A exercises

its powers in legislation and guarantees the bond issue of road authority A. At the time the guarantee is issued, there are no specific counterparties that have been identified, rather the guarantee is implicitly issued in favor of the holders of a specific instrument.

In both these scenarios, assuming that all the other features of a contract are met, the financial guarantee is contractual in nature.

Insurance Contracts

- AG5. Some economic entities in the public sector may include entities that issue insurance contracts. Those entities are within the scope of this Standard, but the insurance contracts themselves are outside the scope of this Standard.
- AG6. For the purposes of this Standard, an insurance contract is a contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (i.e., in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others, and interruption of operations. Additional guidance on insurance contracts is available in the relevant international or national standard dealing with insurance contracts.
- AG7. Some financial instruments take the form of insurance contracts but principally involve the transfer of financial risks, such as market, credit, or liquidity risk. Examples of such instruments include financial guarantee contracts, reinsurance, and guaranteed investment contracts issued by public sector insurers and other entities. An entity is required to apply this Standard to certain financial guarantee contracts, and is permitted to apply this Standard to other insurance contracts that involve the transfer of financial risk.
- AG8. Financial guarantee contracts are treated as financial instruments unless an entity elects to treat them as insurance contracts in accordance with this paragraph and also complies with the requirements of paragraph AG9. An entity may make this election in the following instances:
- (a) If an entity previously applied accounting applicable to insurance contracts and adopted an accounting policy that treated financial guarantee contracts as insurance contracts, it may continue to treat such contracts either as insurance contracts or as financial instruments in accordance with this Standard.
 - (b) If an entity previously did not apply accounting applicable to insurance contracts, it may elect to treat financial guarantee contracts either as insurance contracts or as financial instruments when an entity adopts this Standard.

In both (a) and (b) above, the election is made on a contract by contract basis, and the choice is irrevocable.

- AG9. In accordance with paragraph 3(c), an entity treats financial guarantee contracts as financial instruments unless it elects to treat such contracts as insurance contracts in accordance with the relevant international or national standard dealing with insurance contracts. An entity is permitted to treat a financial guarantee contract as an insurance contract using a national accounting standard only if that standard requires the measurement of insurance liabilities at an amount that is not less than the carrying amount that would be determined if the relevant insurance liabilities were within the scope of IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*. In determining the carrying amount of insurance liabilities, an entity considers the current estimates of all cash flows arising from its insurance contracts and of related cash flows.

Definitions (paragraphs 9–12)

Financial Assets and Financial Liabilities

- AG10. Currency (cash) is a financial asset because it represents the medium of exchange and is therefore the basis on which all transactions are measured and recognized in financial statements. A deposit of cash with a bank or similar financial institution is a financial asset because it represents the contractual right of the depositor to obtain cash from the institution or to draw a check or similar instrument against the balance in favor of a creditor in payment of a financial liability. Unissued currency does not meet the definition of a financial instrument. An entity applies paragraph 13 of IPSAS 12, *Inventories* in accounting for any unissued currency. Currency issued as legal tender from the perspective of the issuer, is not addressed in this Standard.
- AG11. Common examples of financial assets representing a contractual right to receive cash in the future and corresponding financial liabilities representing a contractual obligation to deliver cash in the future are:
- (a) Accounts receivable and payable;
 - (b) Notes receivable and payable;
 - (c) Loans receivable and payable; and
 - (d) Bonds receivable and payable.

In each case, one party's contractual right to receive (or obligation to pay) cash is matched by the other party's corresponding obligation to pay (or right to receive).

- AG12. Another type of financial instrument is one for which the economic benefit to be received or given up is a financial asset other than cash. For example, a note payable in government bonds gives the holder the contractual right to receive and the issuer the contractual obligation to deliver government

bonds, not cash. The bonds are financial assets because they represent obligations of the issuing government to pay cash. The note is, therefore, a financial asset of the note holder and a financial liability of the note issuer.

- AG13. “Perpetual” debt instruments (such as “perpetual” bonds, debentures and capital notes) normally provide the holder with the contractual right to receive payments on account of interest at fixed dates extending into the indefinite future, either with no right to receive a return of principal or a right to a return of principal under terms that make it very unlikely or very far in the future. For example, an entity may issue a financial instrument requiring it to make annual payments in perpetuity equal to a stated interest rate of 8 percent applied to a stated par or principal amount of CU1,000. Assuming 8 percent to be the market rate of interest for the instrument when issued, the issuer assumes a contractual obligation to make a stream of future interest payments having a fair value (present value) of CU1,000 on initial recognition. The holder and issuer of the instrument have a financial asset and a financial liability, respectively.
- AG14. A contractual right or contractual obligation to receive, deliver or exchange financial instruments is itself a financial instrument. A chain of contractual rights or contractual obligations meets the definition of a financial instrument if it will ultimately lead to the receipt or payment of cash or to the acquisition or issue of an equity instrument.
- AG15. The ability to exercise a contractual right or the requirement to satisfy a contractual obligation may be absolute, or it may be contingent on the occurrence of a future event. For example, a financial guarantee is a contractual right of the lender to receive cash from the guarantor, and a corresponding contractual obligation of the guarantor to pay the lender, if the borrower defaults. The contractual right and obligation exist because of a past transaction or event (assumption of the guarantee), even though the lender’s ability to exercise its right and the requirement for the guarantor to perform under its obligation are both contingent on a future act of default by the borrower. A contingent right and obligation meet the definition of a financial asset and a financial liability, even though such assets and liabilities are not always recognized in the financial statements. Some of these contingent rights and obligations may be insurance contracts.
- AG16. Under IPSAS 13, *Leases*, a finance lease is regarded as primarily an entitlement of the lessor to receive, and an obligation of the lessee to pay, a stream of payments that are substantially the same as blended payments of principal and interest under a loan agreement. The lessor accounts for its investment in the amount receivable under the lease contract rather than the leased asset itself. An operating lease, on the other hand, is regarded as primarily an uncompleted contract committing the lessor to provide the use of an asset in future periods in exchange for consideration similar to a fee for a service. The lessor continues to account for the leased asset itself

rather than any amount receivable in the future under the contract. Accordingly, a finance lease is regarded as a financial instrument and an operating lease is not regarded as a financial instrument (except as regards individual payments currently due and payable).

- AG17. Physical assets (such as inventories, property, plant and equipment), leased assets and intangible assets (such as patents and trademarks) are not financial assets. Control of such physical and intangible assets creates an opportunity to generate an inflow of cash or another financial asset, but it does not give rise to a present right to receive cash or another financial asset.
- AG18. Assets (such as prepaid expenses) for which the future economic benefit is the receipt of goods or services, rather than the right to receive cash or another financial asset, are not financial assets. Similarly, items such as deferred revenue and most warranty obligations are not financial liabilities because the outflow of economic benefits associated with them is the delivery of goods and services rather than a contractual obligation to pay cash or another financial asset.
- AG19. Assets and liabilities in the public sector arise out of both contractual and non-contractual arrangements. Assets and liabilities arising out of non-contractual arrangements do not meet the definition of a financial asset or a financial liability.
- AG20. An entity considers the substance rather than the legal form of an arrangement in determining whether it is a “contract” for purposes of this Standard. Contracts, for the purposes of this Standard, are generally evidenced by the following (although this may differ from jurisdiction to jurisdiction):
- Contracts involve willing parties entering into an arrangement;
 - The terms of the contract create rights and obligations for the parties to the contract, and those rights and obligations need not result in equal performance by each party. For example, a donor funding arrangement creates an obligation for the donor to transfer resources to the recipient in terms of the agreement concluded, and establishes the right of the recipient to receive those resources. These types of arrangements may be contractual even though the recipient did not provide equal consideration in return i.e., the arrangement does not result in equal performance by the parties; and
 - The remedy for non-performance is enforceable by law.
- AG21. In the public sector, it is possible that contractual and non-contractual arrangements are non-exchange in nature. Assets and liabilities arising from non-exchange revenue transactions are accounted for in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and*

Transfers). If non-exchange revenue transactions are contractual, an entity assesses if the assets or liabilities arising from such transactions are financial assets or financial liabilities by using paragraphs 10 and AG10–AG18 of this Standard. An entity uses the guidance in this Standard and IPSAS 23 in assessing whether a non-exchange transaction gives rise to a liability or an equity instrument (contribution from owners).

- AG22. An entity would particularly consider the classification requirements of this Standard in determining whether an inflow of resources as part of a contractual non-exchange revenue transaction is in substance a liability or an equity instrument.
- AG23. Statutory obligations can be accounted for in a number of ways:
- Obligations to pay income taxes are accounted for in accordance with the relevant international or national accounting standard dealing with income taxes.
 - Obligations to provide social benefits are accounted for in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* and IPSAS 19.
 - Other statutory obligations are accounted for in accordance with IPSAS 19.
- AG24. Constructive obligations, as defined in IPSAS 19, also do not arise from contracts and are therefore not financial liabilities.

Equity Instruments

- AG25. It is not common for entities in the public sector to have contributed capital comprising equity instruments, for example, shares and other forms of unitized capital. Where entities do issue equity instruments, the ownership and use of those instruments may be restricted by legislation. For example, legislation may stipulate that shares in a public sector entity may only be owned by another public sector entity and may therefore not be used as consideration for the settlement of transactions.
- AG26. Contributed capital in the public sector may also be evidenced by transfers of resources between parties. The issuance of equity instruments in respect of a transfer of resources is not essential for the transfer to meet the definition of a contribution from owners. Transfers of resources that result in an interest in the net assets/equity of an entity are distinguished from other transfers of resources because they may be evidenced by the following:
- A formal designation of a transfer of resources (or a class of such transfers) by the parties to the transaction as forming part of an entity's net assets/equity, either before the contribution occurs or at

the time of the contribution. For example, on establishing a new entity, the budget office of the department of finance may deem that the initial transfers of resources to an entity establish an interest in the net assets/equity of an entity rather than provide funding to meet operational requirements.

- A formal agreement, in relation to the transfer, establishing or increasing an existing financial interest in the net assets/equity of an entity that can be sold, transferred or redeemed.

Even though transfers of resources may be evidenced by a designation or formal agreement, an entity assesses the nature of transfers of resources based on their substance and not merely their legal form.

AG27. For the purposes of this Standard, the term “equity instrument” may be used to denote the following:

- A form of unitized capital such as ordinary or preference shares;
- Transfers of resources (either designated or agreed as such between the parties to the transaction) that evidence a residual interest in the net assets of another entity; and/or
- Financial liabilities in the legal form of debt that, in substance, represent an interest in an entity’s net assets.

Puttable Instruments

AG28. Where an entity’s contributed capital is comprised of shares or other forms of unitized capital, these instruments may take a number of forms, for example non-puttable ordinary shares, some puttable instruments (see paragraphs 15 and 16), some instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation (see paragraphs 17 and 18), some types of preference shares (see paragraphs AG49 and AG50), and warrants or written call options that allow the holder to subscribe for or purchase a fixed number of non-puttable ordinary shares in the issuing entity in exchange for a fixed amount of cash or another financial asset. An entity’s obligation to issue or purchase a fixed number of its own equity instruments in exchange for a fixed amount of cash or another financial asset is an equity instrument of the entity (except as stated in paragraph 27). However, if such a contract contains an obligation for the entity to pay cash or another financial asset (other than a contract classified as an equity instrument in accordance with paragraphs 15 and 16 or paragraphs 17 and 18), it also gives rise to a liability for the present value of the redemption amount (see paragraph AG51(a)). An issuer of non-puttable ordinary shares assumes a liability when it formally acts to make a distribution and becomes legally obliged to the shareholders to do so. This may be the case following the declaration of

a dividend or when the entity is being wound up and any assets remaining after the satisfaction of liabilities become distributable to shareholders.

- AG29. A purchased call option or other similar contract acquired by an entity that gives it the right to reacquire a fixed number of its own equity instruments in exchange for delivering a fixed amount of cash or another financial asset is not a financial asset of the entity (except as stated in paragraph 27). Instead, any consideration paid for such a contract is deducted from net assets/equity.

The Class of Instruments that is Subordinate to all Other Classes (paragraphs 15(b) and 17(b))

- AG30. One of the features of paragraphs 15 and 17 is that the financial instrument is in the class of instruments that is subordinate to all other classes.
- AG31. When determining whether an instrument is in the subordinate class, an entity evaluates the instrument's claim on liquidation as if it were to liquidate on the date when it classifies the instrument. An entity shall reassess the classification if there is a change in relevant circumstances. For example, if the entity issues or redeems another financial instrument, this may affect whether the instrument in question is in the class of instruments that is subordinate to all other classes.
- AG32. An instrument that has a preferential right on liquidation of the entity is not an instrument with an entitlement to a pro rata share of the net assets of the entity. For example, an instrument has a preferential right on liquidation if it entitles the holder to a fixed dividend on liquidation, in addition to a share of the entity's net assets, when other instruments in the subordinate class with a right to a pro rata share of the net assets of the entity do not have the same right on liquidation.
- AG33. If an entity has only one class of financial instruments, that class shall be treated as if it were subordinate to all other classes.

Total Expected Cash Flows Attributable to the Instrument over the Life of the Instrument (paragraph 15(e))

- AG34. The total expected cash flows of the instrument over the life of the instrument must be substantially based on the surplus or deficit, change in the recognized net assets, or fair value of the recognized and unrecognized net assets of the entity over the life of the instrument. Surplus or deficit and the change in the recognized net assets shall be measured in accordance with relevant IPSASs.

Transactions Entered into by an Instrument Holder Other Than as Owner of the Entity (paragraphs 15 and 17)

- AG35. The holder of a puttable financial instrument or an instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation may enter into transactions with the entity in a role other than that of an owner. For example, an instrument holder also may be an employee of the entity. Only the cash flows and the contractual terms and conditions of the instrument that relate to the instrument holder as an owner of the entity shall be considered when assessing whether the instrument should be classified as an equity instrument under paragraph 15 or paragraph 17.
- AG36. An example is a limited partnership that has limited and general partners. Some general partners may provide a guarantee to the entity and may be remunerated for providing that guarantee. In such situations, the guarantee and the associated cash flows relate to the instrument holders in their role as guarantors and not in their roles as owners of the entity. Therefore, such a guarantee and the associated cash flows would not result in the general partners being considered subordinate to the limited partners, and would be disregarded when assessing whether the contractual terms of the limited partnership instruments and the general partnership instruments are identical.
- AG37. Another example is a surplus or deficit sharing arrangement that allocates surpluses and deficits to the instrument holders on the basis of services rendered or business generated during the current and previous years. Such arrangements are transactions with instrument holders in their role as non-owners and should not be considered when assessing the features listed in paragraph 15 or paragraph 17. However, such arrangements that allocate surpluses and deficits to instrument holders based on the nominal amount of their instruments relative to others in the class represent transactions with the instrument holders in their roles as owners and should be considered when assessing the features listed in paragraph 15 or paragraph 17.
- AG38. The cash flows and contractual terms and conditions of a transaction between the instrument holder (in the role as a non-owner) and the issuing entity must be similar to an equivalent transaction that might occur between a non-instrument holder and the issuing entity.

No Other Financial Instrument or Contract with Total Cash Flows that Substantially Fixes or Restricts the Residual Return to the Instrument Holder (paragraphs 16 and 18)

- AG39. A condition for classifying an equity instrument as a financial instrument that otherwise meets the criteria in paragraph 15 or paragraph 17 is that the entity has no other financial instrument or contract that has (a) total cash flows based substantially on the surplus or deficit, the change in the

recognized net assets, or the change in the fair value of the recognized and unrecognized net assets of the entity and (b) the effect of substantially restricting or fixing the residual return. The following instruments, when entered into on normal commercial terms with unrelated parties, are unlikely to prevent instruments that otherwise meet the criteria in paragraph 15 or paragraph 17 from being classified as equity instruments:

- (a) Instruments with total cash flows substantially based on specific assets of the entity.
- (b) Instruments with total cash flows based on a percentage of revenue.
- (c) Contracts designed to reward individual employees for services rendered to the entity.
- (d) Contracts requiring the payment of an insignificant percentage of profit for services rendered or goods provided.

Derivative Financial Instruments

- AG40. Financial instruments include primary instruments (such as receivables, payables and equity instruments) and derivative financial instruments (such as financial options, futures and forwards, interest rate swaps and currency swaps). Derivative financial instruments meet the definition of a financial instrument and, accordingly, are within the scope of this Standard.
- AG41. Derivative financial instruments create rights and obligations that have the effect of transferring between the parties to the instrument one or more of the financial risks inherent in an underlying primary financial instrument. On inception, derivative financial instruments give one party a contractual right to exchange financial assets or financial liabilities with another party under conditions that are potentially favorable, or a contractual obligation to exchange financial assets or financial liabilities with another party under conditions that are potentially unfavorable. However, they generally¹ do not result in a transfer of the underlying primary financial instrument on inception of the contract, nor does such a transfer necessarily take place on maturity of the contract. Some instruments embody both a right and an obligation to make an exchange. Because the terms of the exchange are determined on inception of the derivative instrument, as prices in financial markets change those terms may become either favorable or unfavorable.
- AG42. A put or call option to exchange financial assets or financial liabilities (i.e., financial instruments other than an entity's own equity instruments) gives the holder a right to obtain potential future economic benefits associated with changes in the fair value of the financial instrument underlying the

¹ This is true of most, but not all derivatives, e.g., in some cross-currency interest rate swaps principal is exchanged on inception (and re-exchanged on maturity).

contract. Conversely, the writer of an option assumes an obligation to forgo potential future economic benefits or bear potential losses of economic benefits associated with changes in the fair value of the underlying financial instrument. The contractual right of the holder and obligation of the writer meet the definition of a financial asset and a financial liability, respectively. The financial instrument underlying an option contract may be any financial asset, including shares in other entities and interest-bearing instruments. An option may require the writer to issue a debt instrument, rather than transfer a financial asset, but the instrument underlying the option would constitute a financial asset of the holder if the option were exercised. The option-holder's right to exchange the financial asset under potentially favorable conditions and the writer's obligation to exchange the financial asset under potentially unfavorable conditions are distinct from the underlying financial asset to be exchanged upon exercise of the option. The nature of the holder's right and of the writer's obligation are not affected by the likelihood that the option will be exercised.

- AG43. Another example of a derivative financial instrument is a forward contract to be settled in six months' time in which one party (the purchaser) promises to deliver CU1,000,000 cash in exchange for CU1,000,000 face amount of fixed rate government bonds, and the other party (the seller) promises to deliver CU1,000,000 face amount of fixed rate government bonds in exchange for CU1,000,000 cash. During the six months, both parties have a contractual right and a contractual obligation to exchange financial instruments. If the market price of the government bonds rises above CU1,000,000, the conditions will be favorable to the purchaser and unfavorable to the seller; if the market price falls below CU1,000,000, the effect will be the opposite. The purchaser has a contractual right (a financial asset) similar to the right under a call option held and a contractual obligation (a financial liability) similar to the obligation under a put option written; the seller has a contractual right (a financial asset) similar to the right under a put option held and a contractual obligation (a financial liability) similar to the obligation under a call option written. As with options, these contractual rights and obligations constitute financial assets and financial liabilities separate and distinct from the underlying financial instruments (the bonds and cash to be exchanged). Both parties to a forward contract have an obligation to perform at the agreed time, whereas performance under an option contract occurs only if and when the holder of the option chooses to exercise it.
- AG44. Many other types of derivative instruments embody a right or obligation to make a future exchange, including interest rate and currency swaps, interest rate caps, collars and floors, loan commitments, note issuance facilities, and letters of credit. An interest rate swap contract may be viewed as a variation of a forward contract in which the parties agree to make a series of future exchanges of cash amounts, one amount calculated with reference to a

floating interest rate and the other with reference to a fixed interest rate. Futures contracts are another variation of forward contracts, differing primarily in that the contracts are standardized and traded on an exchange.

Contracts to Buy or Sell Non-Financial Items (paragraphs 4–6)

- AG45. Contracts to buy or sell non-financial items do not meet the definition of a financial instrument because the contractual right of one party to receive a non-financial asset or service and the corresponding obligation of the other party do not establish a present right or obligation of either party to receive, deliver or exchange a financial asset. For example, contracts that provide for settlement only by the receipt or delivery of a non-financial item (e.g., an option, futures or forward contract on oil) are not financial instruments. Many commodity contracts are of this type. Some are standardized in form and traded on organized markets in much the same fashion as some derivative financial instruments. For example, a commodity futures contract may be bought and sold readily for cash because it is listed for trading on an exchange and may change hands many times. However, the parties buying and selling the contract are, in effect, trading the underlying commodity. The ability to buy or sell a commodity contract for cash, the ease with which it may be bought or sold and the possibility of negotiating a cash settlement of the obligation to receive or deliver the commodity do not alter the fundamental character of the contract in a way that creates a financial instrument. Nevertheless, some contracts to buy or sell non-financial items that can be settled net or by exchanging financial instruments, or in which the non-financial item is readily convertible to cash, are within the scope of the Standard as if they were financial instruments (see paragraph 4).
- AG46. A contract that involves the receipt or delivery of physical assets does not give rise to a financial asset of one party and a financial liability of the other party unless any corresponding payment is deferred past the date on which the physical assets are transferred. Such is the case with the purchase or sale of goods on credit.
- AG47. Some contracts are commodity-linked, but do not involve settlement through the physical receipt or delivery of a commodity. They specify settlement through cash payments that are determined according to a formula in the contract, rather than through payment of fixed amounts. For example, the principal amount of a bond may be calculated by applying the market price of oil prevailing at the maturity of the bond to a fixed quantity of oil. The principal is indexed by reference to a commodity price, but is settled only in cash. Such a contract constitutes a financial instrument.
- AG48. The definition of a financial instrument also encompasses a contract that gives rise to a non-financial asset or non-financial liability in addition to a financial asset or financial liability. Such financial instruments often give one party an option to exchange a financial asset for a non-financial asset.

For example, an oil-linked bond may give the holder the right to receive a stream of fixed periodic interest payments and a fixed amount of cash on maturity, with the option to exchange the principal amount for a fixed quantity of oil. The desirability of exercising this option will vary from time to time depending on the fair value of oil relative to the exchange ratio of cash for oil (the exchange price) inherent in the bond. The intentions of the bondholder concerning the exercise of the option do not affect the substance of the component assets. The financial asset of the holder and the financial liability of the issuer make the bond a financial instrument, regardless of the other types of assets and liabilities also created.

Presentation

Liabilities and Net Assets/Equity (paragraphs 13–32)

No Contractual Obligation to Deliver Cash or another Financial Asset (paragraphs 21–24)

- AG49. Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction, or insufficient surpluses or reserves, does not negate the obligation. An option of the issuer to redeem the shares for cash does not satisfy the definition of a financial liability because the issuer does not have a present obligation to transfer financial assets to the shareholders. In this case, redemption of the shares is solely at the discretion of the issuer. An obligation may arise, however, when the issuer of the shares exercises its option, usually by formally notifying the shareholders of an intention to redeem the shares.
- AG50. When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example:
- (a) A history of making distributions;
 - (b) An intention to make distributions in the future;

- (c) A possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends on the ordinary shares if dividends are not paid on the preference shares);
- (d) The amount of the issuer's reserves;
- (e) An issuer's expectation of a surplus or deficit for a period; or
- (f) An ability or inability of the issuer to influence the amount of its surplus or deficit for the period.

Settlement in the Entity's Own Equity Instruments (paragraphs 25–29)

AG51. As noted in paragraph AG25, it is not common for entities in the public sector to issue equity instruments comprising shares or other forms of unitized capital; and where such instruments do exist, their use and ownership is usually restricted in legislation. As a result of the capital structure of public sector entities generally being different from private sector entities, and the legislative environment in which public sector entities operate, transactions that are settled in an entity's own equity instruments are not likely to occur as frequently in the public sector as in the private sector. However, where such transactions do occur, the following examples may assist in illustrating how to classify different types of contracts on an entity's own equity instruments:

- (a) A contract that will be settled by the entity receiving or delivering a fixed number of its own shares for no future consideration, or exchanging a fixed number of its own shares for a fixed amount of cash or another financial asset, is an equity instrument (except as stated in paragraph 27). Accordingly, any consideration received or paid for such a contract is added directly to or deducted directly from net assets/equity. One example is an issued share option that gives the counterparty a right to buy a fixed number of the entity's shares for a fixed amount of cash. However, if the contract requires the entity to purchase (redeem) its own shares for cash or another financial asset at a fixed or determinable date or on demand, the entity also recognizes a financial liability for the present value of the redemption amount (with the exception of instruments that have all the features and meet the conditions in paragraph 15 and 16 or paragraphs 17 and 18). One example is an entity's obligation under a forward contract to repurchase a fixed number of its own shares for a fixed amount of cash.
- (b) An entity's obligation to purchase its own shares for cash gives rise to a financial liability for the present value of the redemption amount even if the number of shares that the entity is obliged to repurchase is not fixed or if the obligation is conditional on the counterparty

exercising a right to redeem (except as stated in paragraphs 15 and 16 or paragraphs 17 and 18). One example of a conditional obligation is an issued option that requires the entity to repurchase its own shares for cash if the counterparty exercises the option.

- (c) A contract that will be settled in cash or another financial asset is a financial asset or financial liability even if the amount of cash or another financial asset that will be received or delivered is based on changes in the market price of the entity's own equity instruments (except as stated in paragraphs 15 and 16 or paragraphs 17 and 18). One example is a net cash-settled share option.

A contract that will be settled in a variable number of the entity's own shares whose value equals a fixed amount or an amount based on changes in an underlying variable (e.g., a commodity price) is a financial asset or a financial liability. An example is a written option to buy oil that, if exercised, is settled net in the entity's own instruments by the entity delivering as many of those instruments as are equal to the value of the option contract. Such a contract is a financial asset or financial liability even if the underlying variable is the entity's own share price rather than oil. Similarly, a contract that will be settled in a fixed number of the entity's own shares, but the rights attaching to those shares will be varied so that the settlement value equals a fixed amount or an amount based on changes in an underlying variable, is a financial asset or a financial liability.

Contingent Settlement Provisions (paragraph 30)

- AG52. Paragraph 30 requires that if a part of a contingent settlement provision that could require settlement in cash or another financial asset (or in another way that would result in the instrument being a financial liability) is not genuine, the settlement provision does not affect the classification of a financial instrument. Thus, a contract that requires settlement in cash or a variable number of the entity's own shares only on the occurrence of an event that is extremely rare, highly abnormal and very unlikely to occur is an equity instrument. Similarly, settlement in a fixed number of an entity's own shares may be contractually precluded in circumstances that are outside the control of the entity, but if these circumstances have no genuine possibility of occurring, classification as an equity instrument is appropriate.

Treatment in Consolidated Financial Statements

- AG53. In consolidated financial statements, an entity presents non-controlling interests i.e., the interests of other parties in the net assets/equity and revenue of its controlled entities in accordance with IPSAS 1 and IPSAS 6. When classifying a financial instrument (or a component of it) in consolidated financial statements, an entity considers all terms and conditions agreed between members of the economic entity and the holders

of the instrument in determining whether the economic entity as a whole has an obligation to deliver cash or another financial asset in respect of the instrument or to settle it in a manner that results in liability classification. When a controlled entity issues a financial instrument and a controlling entity or other entity within the economic entity agrees additional terms directly with the holders of the instrument (e.g., a guarantee), the economic entity may not have discretion over distributions or redemption. Although the controlled entity may appropriately classify the instrument without regard to these additional terms in its individual financial statements, the effect of other agreements between members of the economic entity and the holders of the instrument is considered in order to ensure that consolidated financial statements reflect the contracts and transactions entered into by the economic entity as a whole. To the extent that there is such an obligation or settlement provision, the instrument (or the component of it that is subject to the obligation) is classified as a financial liability in consolidated financial statements.

- AG54. Some types of instruments that impose a contractual obligation on the entity are classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. Classification in accordance with those paragraphs is an exception to the principles otherwise applied in this Standard to the classification of an instrument and cannot be applied by analogy to other instruments. This exception is not extended to the classification of non-controlling interests in the consolidated financial statements. Therefore, instruments classified as equity instruments in accordance with either paragraphs 15 and 16 or paragraphs 17 and 18 in the separate or individual financial statements that are non-controlling interests are classified as liabilities in the consolidated financial statements of the economic entity.

Compound Financial Instruments (paragraphs 33–37)

- AG55. Paragraph 33 applies only to issuers of non-derivative compound financial instruments. Paragraph 33 does not deal with compound financial instruments from the perspective of holders. IPSAS 29 deals with the separation of embedded derivatives from the perspective of holders of compound financial instruments that contain the features of both debt and equity instruments.
- AG56. Compound financial instruments are not common in the public sector because of the capital structure of public sector entities. The following discussion does, however, illustrate how a compound financial instrument would be analyzed into its component parts. A common form of compound financial instrument is a debt instrument with an embedded conversion option, such as a bond convertible into ordinary shares of the issuer, and without any other embedded derivative features. Paragraph 33 requires the

issuer of such a financial instrument to present the liability component and net assets/equity component separately in the statement of financial position, as follows:

- (a) The issuer's obligation to make scheduled payments of interest and principal is a financial liability that exists as long as the instrument is not converted. On initial recognition, the fair value of the liability component is the present value of the contractually determined stream of future cash flows discounted at the rate of interest applied at that time by the market to instruments of comparable credit status and providing substantially the same cash flows, on the same terms, but without the conversion option.
- (b) The equity instrument is an embedded option to convert the liability into net assets/equity of the issuer. The fair value of the option comprises its time value and its intrinsic value, if any. This option has value on initial recognition even when it is out of the money.

AG57. On conversion of a convertible instrument at maturity, the entity derecognizes the liability component and recognizes it as net assets/equity. The original net assets/equity component remains as net assets/equity (although it may be transferred from one line item within net assets/equity to another.) There is no gain or loss on conversion at maturity.

AG58. When an entity extinguishes a convertible instrument before maturity through an early redemption or repurchase in which the original conversion privileges are unchanged, the entity allocates the consideration paid and any transaction costs for the repurchase or redemption to the components of the instrument at the date of the transaction. The method used in allocating the consideration paid and transaction costs to the separate components is consistent with that used in the original allocation to the separate components of the proceeds received by the entity when the convertible instrument was issued, in accordance with paragraphs 33–37.

AG59. Once the allocation of the consideration is made, any resulting gain or loss is treated in accordance with accounting principles applicable to the related component, as follows:

- (a) The amount of gain or loss relating to the liability component is recognized in surplus or deficit; and
- (b) The amount of consideration relating to the net assets/equity component is recognized in net assets/equity.

AG60. An entity may amend the terms of a convertible instrument to induce early conversion, for example by offering a more favorable conversion ratio or paying other additional consideration in the event of conversion before a specified date. The difference, at the date the terms are amended, between the fair value of the consideration the holder receives on conversion of the

instrument under the revised terms and the fair value of the consideration the holder would have received under the original terms is recognized as a loss in surplus or deficit.

Treasury Shares (paragraphs 38 and 39)

- AG61. An entity's own equity instruments are not recognized as a financial asset regardless of the reason for which they are reacquired. Paragraph 38 requires an entity that reacquires its own equity instruments to deduct those equity instruments from net assets/equity. However, when an entity holds its own equity instruments on behalf of others, for example, a financial institution holding its own equity instruments on behalf of a client, there is an agency relationship and as a result those holdings are not included in the entity's statement of financial position.

Interest, Dividends or Similar Distributions, Losses, and Gains (paragraphs 40–46)

- AG62. The following example illustrates the application of paragraph 40 to a compound financial instrument. Assume that a non-cumulative preference share is mandatorily redeemable for cash in five years, but that dividends are payable at the discretion of the entity before the redemption date. Such an instrument is a compound financial instrument, with the liability component being the present value of the redemption amount. The unwinding of the discount on this component is recognized in surplus or deficit and classified as interest expense. Any dividends paid relate to the net assets/equity component and, accordingly, are recognized as a distribution of surplus or deficit. A similar treatment would apply if the redemption was not mandatory but at the option of the holder, or if the share was mandatorily convertible into a variable number of ordinary shares calculated to equal a fixed amount or an amount based on changes in an underlying variable (for example, a commodity). However, if any unpaid dividends or similar distributions are added to the redemption amount, the entire instrument is a liability. In such a case, any dividends or similar distributions are classified as interest expense.

Offsetting a Financial Asset and a Financial Liability (paragraphs 47–55)

- AG63. To offset a financial asset and a financial liability, an entity must have a currently enforceable legal right to set off the recognized amounts. An entity may have a conditional right to set off recognized amounts, such as in a master netting agreement or in some forms of non-recourse debt, but such rights are enforceable only on the occurrence of some future event, usually a default of the counterparty. Thus, such an arrangement does not meet the conditions for offset.
- AG64. The Standard does not provide special treatment for so-called “synthetic instruments,” which are groups of separate financial instruments acquired

and held to emulate the characteristics of another instrument. For example, a floating rate long-term debt combined with an interest rate swap that involves receiving floating payments and making fixed payments synthesizes a fixed rate long-term debt. Each of the individual financial instruments that together constitute a “synthetic instrument” represents a contractual right or obligation with its own terms and conditions and each may be transferred or settled separately. Each financial instrument is exposed to risks that may differ from the risks to which other financial instruments are exposed. Accordingly, when one financial instrument in a “synthetic instrument” is an asset and another is a liability, they are not offset and presented in an entity’s statement of financial position on a net basis unless they meet the criteria for offsetting in paragraph 47.

Appendix B

Members' Shares in Co-operative Entities and Similar Instruments

This Appendix is an integral part of IPSAS 28.

Introduction

- B1. Co-operatives and other similar entities are formed by groups of persons to meet common economic or social needs. National laws typically define a co-operative as a society endeavoring to promote its members' economic advancement by way of a joint business operation (the principle of self-help). Members' interests in a co-operative are often characterised as members' shares, units or the like, and are referred to below as "members' shares." This Appendix applies to financial instruments issued to members of co-operative entities that evidence the members' ownership interest in the entity and does not apply to financial instruments that will or may be settled in the entity's own equity instruments.
- B2. IPSAS 28 establishes principles for the classification of financial instruments as financial liabilities or net assets/equity. In particular, those principles apply to the classification of puttable instruments that allow the holder to put those instruments to the issuer for cash or another financial instrument. The application of those principles to members' shares in co-operative entities and similar instruments is difficult. This guidance is provided to illustrate the application of the principles in IPSAS 28 to members' shares and similar instruments that have certain features, and the circumstances in which those features affect the classification as liabilities or net assets/equity.
- B3. Many financial instruments, including members' shares, have characteristics of equity instruments, including voting rights and rights to participate in dividend or similar distributions. Some financial instruments give the holder the right to request redemption for cash or another financial asset, but may include or be subject to limits on whether the financial instruments will be redeemed. The following paragraphs outline how those redemption terms should be evaluated in determining whether the financial instruments should be classified as liabilities or net assets/equity.

Application of IPSASs to Members' Shares in Co-operative Entities and Similar Instruments

- B4. The contractual right of the holder of a financial instrument (including members' shares in co-operative entities) to request redemption does not, in itself, require that financial instrument to be classified as a financial liability. Rather, the entity must consider all of the terms and conditions of the financial instrument in determining its classification as a financial liability or an equity

instrument. Those terms and conditions include relevant local laws, regulations and the entity's governing charter in effect at the date of classification, but not expected future amendments to those laws, regulations or charter.

- B5. Members' shares that would be classified as equity instruments if the members did not have a right to request redemption are equity instruments if either of the conditions described in paragraphs B6 and B7 is present or the members' shares have all the features and meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18 of IPSAS 28. Demand deposits, including current accounts, deposit accounts and similar contracts that arise when members act as customers are financial liabilities of the entity.
- B6. Members' shares are equity instruments if the entity has an unconditional right to refuse redemption of the members' shares.
- B7. Local law, regulation or the entity's governing charter can impose various types of prohibitions on the redemption of members' shares, e.g., unconditional prohibitions or prohibitions based on liquidity criteria. If redemption is unconditionally prohibited by local law, regulation or the entity's governing charter, members' shares are equity instruments. However, provisions in local law, regulation or the entity's governing charter that prohibit redemption only if conditions—such as liquidity constraints—are met (or are not met) do not result in members' shares being equity instruments.
- B8. An unconditional prohibition may be absolute, in that all redemptions are prohibited. An unconditional prohibition may be partial, in that it prohibits redemption of members' shares if redemption would cause the number of members' shares or amount of paid-in capital from members' shares to fall below a specified level. Members' shares in excess of the prohibition against redemption are liabilities, unless the entity has the unconditional right to refuse redemption as described in paragraph B6 or the members' shares have all the features and meet the conditions in paragraphs 15 and 16 or paragraphs 17 and 18 of IPSAS 28. In some cases, the number of shares or the amount of paid-in capital subject to a redemption prohibition may change from time to time. Such a change in the redemption prohibition leads to a transfer between financial liabilities and net assets/equity.
- B9. At initial recognition, the entity shall measure its financial liability for redemption at fair value. In the case of members' shares with a redemption feature, the entity measures the fair value of the financial liability for redemption at no less than the maximum amount payable under the redemption provisions of its governing charter or applicable law discounted from the first date that the amount could be required to be paid (see example 3).
- B10. As required by paragraph 40 of IPSAS 28, distributions to holders of equity instruments are recognized directly in net assets/equity, net of any income tax

benefits. Interest, dividends or similar distributions and other returns relating to financial instruments classified as financial liabilities are expenses, regardless of whether those amounts paid are legally characterized as dividends or similar distributions, interest or otherwise.

- B11. When a change in the redemption prohibition leads to a transfer between financial liabilities and net assets/equity, the entity shall disclose separately the amount, timing and reason for the transfer.
- B12. The following examples illustrate the application of the preceding paragraphs.

Illustrative Examples

The examples do not constitute an exhaustive list; other fact patterns are possible. Each example assumes that there are no conditions other than those set out in the facts of the example that would require the financial instrument to be classified as a financial liability and that the financial instrument does not have all the features or does not meet the conditions in paragraph 15 and 16 or paragraphs 17 and 18 of IPSAS 28.

Unconditional Right to Refuse Redemption (paragraph B6)

Example 1

Facts

- B13. The entity's charter states that redemptions are made at the sole discretion of the entity. The charter does not provide further elaboration or limitation on that discretion. In its history, the entity has never refused to redeem members' shares, although the governing board has the right to do so.

Classification

- B14. The entity has the unconditional right to refuse redemption and the members' shares are equity instruments. IPSAS 28 establishes principles for classification that are based on the terms of the financial instrument and notes that a history of, or intention to make, discretionary payments does not trigger liability classification. Paragraph AG50 of IPSAS 28 states:

When preference shares are non-redeemable, the appropriate classification is determined by the other rights that attach to them. Classification is based on an assessment of the substance of the contractual arrangements and the definitions of a financial liability and an equity instrument. When distributions to holders of the preference shares, whether cumulative or non-cumulative, are at the discretion of the issuer, the shares are equity instruments. The classification of a preference share as an equity instrument or a financial liability is not affected by, for example:

- (a) A history of making distributions;
- (b) An intention to make distributions in the future;

- (c) A possible negative impact on the price of ordinary shares of the issuer if distributions are not made (because of restrictions on paying dividends on the ordinary shares if dividends are not paid on the preference shares);
- (d) The amount of the issuer's reserves;
- (e) An issuer's expectation of a surplus or deficit for a period; or
- (f) An ability or inability of the issuer to influence the amount of its surplus or deficit for the period.

Example 2

Facts

- B15. The entity's charter states that redemptions are made at the sole discretion of the entity. However, the charter further states that approval of a redemption request is automatic unless the entity is unable to make payments without violating local regulations regarding liquidity or reserves.

Classification

- B16. The entity does not have the unconditional right to refuse redemption and the members' shares are classified as a financial liability. The restrictions described above are based on the entity's ability to settle its liability. They restrict redemptions only if the liquidity or reserve requirements are not met and then only until such time as they are met. Hence, they do not, under the principles established in IPSAS 28, result in the classification of the financial instrument as equity instruments. Paragraph AG49 of IPSAS 28 states:

Preference shares may be issued with various rights. In determining whether a preference share is a financial liability or an equity instrument, an issuer assesses the particular rights attaching to the share to determine whether it exhibits the fundamental characteristic of a financial liability. For example, a preference share that provides for redemption on a specific date or at the option of the holder contains a financial liability because the issuer has an obligation to transfer financial assets to the holder of the share. *The potential inability of an issuer to satisfy an obligation to redeem a preference share when contractually required to do so, whether because of a lack of funds, a statutory restriction or insufficient surpluses or reserves, does not negate the obligation.* [Emphasis added]

Prohibitions against Redemption (paragraphs B7 and B8)

Example 3

Facts

- B17. A co-operative entity has issued shares to its members at different dates and for different amounts in the past as follows:

- (a) January 1, 20X1 100,000 shares at CU10 each (CU1,000,000);
- (b) January 1, 20X2 100,000 shares at CU20 each (a further CU2,000,000, so that the total for shares issued is CU3,000,000).

Shares are redeemable on demand at the amount for which they were issued.

- B18. The entity's charter states that cumulative redemptions cannot exceed 20 percent of the highest number of its members' shares ever outstanding. At December 31, 20X2 the entity has 200,000 of outstanding shares, which is the highest number of members' shares ever outstanding and no shares have been redeemed in the past. On January 1, 20X3 the entity amends its governing charter and increases the permitted level of cumulative redemptions to 25 percent of the highest number of its members' shares ever outstanding.

Classification

Before the Governing Charter is Amended

- B19. Members' shares in excess of the prohibition against redemption are financial liabilities. The co-operative entity measures this financial liability at fair value at initial recognition. Because these shares are redeemable on demand, the co-operative entity determines the fair value of such financial liabilities as required by paragraph 52 of IPSAS 29, which states: "The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand ..." Accordingly, the co-operative entity classifies as financial liabilities the maximum amount payable on demand under the redemption provisions.
- B20. On January 1, 20X1 the maximum amount payable under the redemption provisions is 20,000 shares at CU10 each and accordingly the entity classifies CU200,000 as financial liability and CU800,000 as equity instruments. However, on January 1, 20X2 because of the new issue of shares at CU20, the maximum amount payable under the redemption provisions increases to 40,000 shares at CU20 each. The issue of additional shares at CU20 creates a new liability that is measured on initial recognition at fair value. The liability after these shares have been issued is 20 percent of the total shares in issue (200,000), measured at CU20, or CU800,000. This requires recognition of an additional liability of CU600,000. In this example no gain or loss is recognized. Accordingly the entity now classifies CU800,000 as financial liabilities and CU2,200,000 as equity instruments. This example assumes these amounts are not changed between January 1, 20X1 and December 31, 20X2.

After the Governing Charter is Amended

- B21. Following the change in its governing charter the co-operative entity can now be required to redeem a maximum of 25 percent of its outstanding shares or a maximum of 50,000 shares at CU20 each. Accordingly, on January 1, 20X3 the co-operative entity classifies as financial liabilities an amount of CU1,000,000 being the maximum amount payable on demand under the redemption provisions, as determined in accordance with paragraph 52 of IPSAS 28. It therefore transfers on January 1, 20X3 from net assets/equity to

financial liabilities an amount of CU200,000, leaving CU2,000,000 classified as equity instruments. In this example the entity does not recognize a gain or loss on the transfer.

Example 4

Facts

- B22. Local law governing the operations of co-operatives, or the terms of the entity's governing charter, prohibit an entity from redeeming members' shares if, by redeeming them, it would reduce paid-in capital from members' shares below 75 percent of the highest amount of paid-in capital from members' shares. The highest amount for a particular co-operative is CU1,000,000. At the end of the reporting period the balance of paid-in capital is CU900,000.

Classification

- B23. In this case, CU750,000 would be classified as equity instruments and CU150,000 would be classified as financial liabilities. In addition to the paragraphs already cited, paragraph 22(b) of IPSAS 28 states in part:

... a financial instrument that gives the holder the right to put it back to the issuer for cash or another financial asset (a "puttable instrument") is a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18. The financial instrument is a financial liability even when the amount of cash or other financial assets is determined on the basis of an index or other item that has the potential to increase or decrease. The existence of an option for the holder to put the instrument back to the issuer for cash or another financial asset means that the puttable instrument meets the definition of a financial liability, except for those instruments classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18.

- B24. The redemption prohibition described in this example is different from the restrictions described in paragraphs 23 and AG49 of IPSAS 28. Those restrictions are limitations on the ability of the entity to pay the amount due on a financial liability, i.e., they prevent payment of the liability only if specified conditions are met. In contrast, this example describes an unconditional prohibition on redemptions beyond a specified amount, regardless of the entity's ability to redeem members' shares (e.g., given its cash resources, surpluses or distributable reserves). In effect, the prohibition against redemption prevents the entity from incurring any financial liability to redeem more than a specified amount of paid-in capital. Therefore, the portion of shares subject to the redemption prohibition is not a financial liability. While each member's shares may be redeemable individually, a portion of the total shares outstanding is not redeemable in any circumstances other than liquidation of the entity.

Example 5*Facts*

- B25. The facts of this example are as stated in example 4. In addition, at the end of the reporting period, liquidity requirements imposed in the local jurisdiction prevent the entity from redeeming any members' shares unless its holdings of cash and short-term investments are greater than a specified amount. The effect of these liquidity requirements at the end of the reporting period is that the entity cannot pay more than CU50,000 to redeem the members' shares.

Classification

- B26. As in example 4, the entity classifies CU750,000 as equity instruments and CU150,000 as a financial liability. This is because the amount classified as a liability is based on the entity's unconditional right to refuse redemption and not on conditional restrictions that prevent redemption only if liquidity or other conditions are not met and then only until such time as they are met. The provisions of paragraphs 23 and AG49 of IPSAS 28 apply in this case.

Example 6*Facts*

- B27. The entity's governing charter prohibits it from redeeming members' shares, except to the extent of proceeds received from the issue of additional members' shares to new or existing members during the preceding three years. Proceeds from issuing members' shares must be applied to redeem shares for which members have requested redemption. During the three preceding years, the proceeds from issuing members' shares have been CU12,000 and no member's shares have been redeemed.

Classification

- B28. The entity classifies CU12,000 of the members' shares as financial liabilities. Consistently with the conclusions described in example 4, members' shares subject to an unconditional prohibition against redemption are not financial liabilities. Such an unconditional prohibition applies to an amount equal to the proceeds of shares issued before the preceding three years, and accordingly, this amount is classified as equity instruments. However, an amount equal to the proceeds from any shares issued in the preceding three years is not subject to an unconditional prohibition on redemption. Accordingly, proceeds from the issue of members' shares in the preceding three years give rise to financial liabilities until they are no longer available for redemption of members' shares. As a result the entity has a financial liability equal to the proceeds of shares issued during the three preceding years, net of any redemptions during that period.

Example 7*Facts*

- B29. The entity is a co-operative bank. Local law governing the operations of co-operative banks state that at least 50 percent of the entity's total "outstanding liabilities" (a term defined in the regulations to include members' share accounts) has to be in the form of members' paid-in capital. The effect of the regulation is that if all of a co-operative's outstanding liabilities are in the form of members' shares, it is able to redeem them all. On December 31, 20X1 the entity has total outstanding liabilities of CU200,000, of which CU125,000 represent members' share accounts. The terms of the members' share accounts permit the holder to redeem them on demand and there are no limitations on redemption in the entity's charter.

Classification

- B30. In this example members' shares are classified as financial liabilities. The redemption prohibition is similar to the restrictions described in paragraphs 23 and AG49 of IPSAS 28. The restriction is a conditional limitation on the ability of the entity to pay the amount due on a financial liability, i.e., they prevent payment of the liability only if specified conditions are met. More specifically, the entity could be required to redeem the entire amount of members' shares (CU125,000) if it repaid all of its other liabilities (CU75,000). Consequently, the prohibition against redemption does not prevent the entity from incurring a financial liability to redeem more than a specified number of members' shares or amount of paid-in capital. It allows the entity only to defer redemption until a condition is met, i.e., the repayment of other liabilities. Members' shares in this example are not subject to an unconditional prohibition against redemption and are therefore classified as financial liabilities.

Appendix C

Amendments to Other IPSASs

IPSAS 1, *Presentation of Financial Statements*

An additional paragraph is inserted after paragraph 7 as follows:

Definitions

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

- (a) Puttable financial instrument classified as an equity instrument (described in paragraphs 15 and 16 of IPSAS 28);
- (b) An instrument that imposes on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and is classified as an equity instrument (described in paragraphs 17 and 18 of IPSAS 28).

An additional paragraph is inserted after paragraph 95 as follows:

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

95A. If an entity has reclassified:

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

between financial liabilities and net assets/equity, it shall disclose the amount reclassified into and out of each category (financial liabilities or net assets/equity), and the timing and reason for that reclassification.

An additional header and paragraph are inserted after paragraph 148C as follows:

Puttable Financial Instruments Classified as Net Assets/Equity

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

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

- (b) Its objectives, policies and processes for managing its obligation to repurchase or redeem the instruments when required to do so by the instrument holders, including any changes from the previous period;
- (c) The expected cash outflow on redemption or repurchase of that class of financial instruments; and
- (d) Information about how the expected cash outflow on redemption or repurchase was determined.

Two additional sub-paragraphs are inserted after sub-paragraph 150(d) as follows:

Other Disclosures

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

...

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

A new paragraph is inserted after paragraph 153A as follows:

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

IPSAS 23, Revenue from Non-Exchange Transactions (Taxes and Transfers)

Paragraph 37 is amended as follows:

Contributions from Owners

37. Contributions from owners are defined in IPSAS 1. For a transaction to qualify as a contribution from owners, it will be necessary to satisfy the characteristics identified in that definition. In determining whether a transaction satisfies the definition of a contribution from owners, the substance rather than the form of the transaction is considered. Paragraph 38 indicates the form that contributions from owners may take. If, despite the form of the transaction, the substance is clearly that of a loan or another kind of liability, or revenue, the entity recognizes it as such and makes an appropriate disclosure in the notes to the general purpose financial statements, if material. For example, if a transaction purports to be a contribution from owners, but specifies that the reporting entity will pay fixed distributions to the transferor, with a return of the transferor's investment at a specified future time, the transaction is more characteristic

of a loan. For contractual arrangements, an entity also considers the guidance in IPSAS 28, *Financial Instruments: Presentation* when distinguishing liabilities from contributions from owners.

A new paragraph is inserted after paragraph 124 as follows:

124A. IPSAS 28 amended paragraph 37. An entity shall apply the amendment for annual financial statements covering periods beginning on or after January 1, 2013. If an entity applies IPSAS 28 for a period beginning before January 1, 2013, the amendment shall also be applied for that earlier period.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 28.

Introduction

- BC1. This Basis for Conclusions summarizes the International Public Sector Accounting Standards Board's (IPSASB) considerations in reaching the conclusions in IPSAS 28, *Financial Instruments: Presentation*. As this Standard is primarily drawn from IAS 32, *Financial Instruments: Presentation* issued by the International Accounting Standards Board (IASB), the Basis for Conclusions outlines only those areas where the IPSAS 28 departs from the main requirements of IAS 32.
- BC2. This project on financial instruments is a key part of the IPSASB's convergence program, which aims to converge IPSASs with International Financial Reporting Standards (IFRSs). The IPSASB acknowledges that there are other aspects of financial instruments, in so far as they relate to the public sector, which are not addressed in IAS 32. These may be addressed by future projects of the IPSASB. In particular, the IPSASB acknowledges that future projects may be required to address:
- Certain transactions undertaken by central banks; and
 - Receivables and payables that arise from arrangements that are, in substance, similar to, and have the same economic effect as, financial instruments, but are not contractual in nature.
- BC3. In developing this Standard, the IPSASB agreed to retain the existing text of IAS 32, making changes to ensure consistency with the terminology and presentational requirements of other IPSASs, and deal with any public sector specific issues through additional Application Guidance.
- BC4. In September 2007, the IASB issued amendments to IAS 1, *Presentation of Financial Statements* which introduced "comprehensive income" into the presentation of financial statements. As the IPSASB has not yet considered comprehensive income, along with some of the other amendments to IAS 1, those amendments have not been included in IPSAS 28.

Scope

Insurance and Financial Guarantee Contracts

- BC5. IAS 32 excludes all insurance contracts from the scope of IAS 32, except for financial guarantee contracts where the issuer applies IAS 39, *Financial Instruments: Recognition and Measurement* in recognizing and measuring such contracts. The scope of IPSAS 28 also excludes all insurance contracts, except that:

- Financial guarantee contracts are to be treated as financial instruments unless an entity elects to treat such contracts as insurance contracts in accordance with the relevant international or national accounting standard dealing with insurance contracts; and
- Contracts that are insurance contracts but involve the transfer of financial risk may be treated as financial instruments in accordance with IPSAS 28, IPSAS 29 and IPSAS 30.

Treating Financial Guarantees as Financial Instruments

- BC6. Under IAS 32, financial guarantee contracts should be treated as financial instruments, unless an issuer elects to apply IFRS 4 to those contracts. Unlike in the private sector, many financial guarantee contracts are issued in the public sector by way of a non-exchange transaction, i.e., at no or nominal consideration. So as to enhance the comparability of financial statements and, given the significance of financial guarantee contracts issued by way of non-exchange transactions in the public sector, the IPSASB had proposed that such guarantees should be treated as financial instruments and entities should not be permitted to treat them as insurance contracts.
- BC7. In response to this proposal, some respondents agreed that the treatment of financial guarantee contracts issued through non-exchange transactions as financial instruments, rather than as insurance contracts, is appropriate because the business models for exchange and non-exchange insurance contracts are different. Others argued that entities should be allowed to treat such guarantees as insurance contracts or financial instruments using an election similar to that in IFRS 4.
- BC8. The IPSASB concluded that the same approach should be applied to financial guarantee contracts, regardless of whether they are issued through exchange or non-exchange transactions, because the underlying liability that should be recognized in an entity's financial statements does not differ. The IPSASB agreed that entities should be permitted a choice of treating financial guarantee contracts, either as insurance contracts or financial instruments, subject to certain conditions.
- BC9. In evaluating the circumstances under which an entity may elect to treat financial guarantee contracts as insurance contracts, the IPSASB considered the requirements of IFRS 4. The election to treat financial guarantee contracts as financial instruments or insurance contracts under IFRS 4 is available only to those entities that previously explicitly asserted that they deem such contracts to be insurance contracts. The IPSASB, however, recognized that not all entities that have adopted accrual accounting apply IFRS 4. It acknowledged that it should also consider scenarios where, for example, entities applied accrual accounting but did not recognize assets and liabilities relating to insurance contracts, as well as entities that previously did not apply

accrual accounting. Consequently, the IPSASB agreed that the existing requirements in IFRS 4 were too onerous and would need to be modified in the context of this Standard.

BC10. The IPSASB therefore agreed that entities that previously:

- (a) Applied insurance accounting and adopted an accounting policy that treated financial guarantee contracts as insurance contracts, could continue to treat those guarantees as insurance contracts or as financial instruments; and
- (b) Did not apply insurance accounting would be allowed a choice of treating financial guarantee contracts either as insurance contracts or financial instruments when they adopt this Standard.

In both instances, the election is irrevocable.

BC11. The IPSASB considered whether entities should be allowed to elect to treat financial guarantees as insurance contracts on a contract-by-contract basis or, whether entities should be required to make a general accounting policy choice. It was agreed that the choice should be made on an individual contract basis to allow entities within an economic entity to treat financial guarantees as insurance contracts or financial instruments, based on the nature of their businesses.

BC12. The IPSASB agreed, as a precondition for allowing entities to treat financial guarantees as insurance contracts, that the accounting practices applied by entities for insurance contracts should meet certain requirements. The IPSASB agreed that if entities elected to treat financial guarantee contracts as insurance contracts, that they must apply either IFRS 4 or a national accounting standard that requires insurance liabilities to be measured at a minimum value. That minimum value is determined as if the insurance liabilities were within the scope of IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* using the current estimates of cash flows arising from an entity's insurance contracts and of any related cash flows.

Option to Treat Insurance Contracts that Transfer Financial Risk as Financial Instruments

BC13. IPSAS 15 allowed entities to account for contracts that are insurance contracts that result in the transfer of financial risk, as financial instruments. In the absence of an IPSAS on insurance contracts, the IPSASB concluded that it should allow, but not require, entities to apply IPSAS 28 to such contracts.

Identifying Contractual Financial Guarantees

BC14. Financial instruments in IPSAS 28 are defined as: "...any contract that gives rise to a financial asset of one entity and a financial liability or equity

instrument of another entity.” As arrangements in the public sector may arise through statutory powers, the IPSASB developed additional application guidance to identify when financial guarantees are contractual. The IPSASB concluded that, to be within the scope of IPSAS 28, financial guarantees should have the key features of a contractual arrangement. The IPSASB also concluded that an entity should distinguish the right to issue guarantees, which is often conferred on an entity through statutory or similar means, and the actual issuing of the guarantee in favour of a third party, irrespective of whether that party is explicitly or implicitly identified. A statutory right to issue guarantees, of itself, is not within the scope of this Standard.

Definitions

Contractual Arrangements

BC15. The IPSASB noted that, in certain jurisdictions, public sector entities are precluded from entering into formal contracts, but do enter into arrangements that have the substance of contracts. These arrangements may be known by another term, e.g., a “government order.” To assist entities in identifying contracts, which either have the substance or legal form of a contract, the IPSASB considered it appropriate to issue additional Application Guidance explaining the factors an entity should consider in assessing whether an arrangement is contractual or non-contractual.

BC16. Consideration was given as to whether the term “binding arrangement” should be used to describe the arrangements highlighted in paragraph BC15. The term “binding arrangement” has not been defined, but has been used in IPSASs to describe arrangements that are binding on the parties, but do not take the form of a documented contract, such as an arrangement between two government departments that do not have the power to contract. The IPSASB concluded that the term “binding arrangements,” as used in IPSASs, embraces a wider set of arrangements than those identified in paragraph BC15 and therefore concluded that it should not be used in this IPSAS 28.

Contractual Non-Exchange Revenue Transactions

BC17. IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* prescribes the initial recognition, initial measurement and disclosure of assets and liabilities arising out of non-exchange revenue transactions. The IPSASB considered the interaction between this Standard and IPSAS 23.

BC18. In considering whether assets and liabilities that arise from non-exchange revenue transactions are financial assets and financial liabilities, the IPSASB identified that the following basic requirements should be fulfilled:

- The arrangement is contractual in nature; and

- The arrangement gives rise to a contractual right or obligation to receive or deliver cash or another financial asset, or exchange financial assets under favorable or unfavorable conditions.

BC19. The IPSASB concluded that assets arising from non-exchange revenue transactions could meet these requirements. In particular, it noted that the nature of arrangements with donors may be contractual in nature, and may be settled by transferring cash or another financial asset from the donor to the recipient. In these instances, assets arising from non-exchange revenue transactions are financial assets.

BC20. The IPSASB agreed that, for financial assets arising from non-exchange transactions, an entity should apply the requirements of IPSAS 23 in conjunction with IPSAS 28. In particular, an entity considers the principles in IPSAS 28 in considering whether an inflow of resources from a non-exchange revenue transaction results in a liability or a transaction that evidences a residual interest in the net assets of the entity, i.e., an equity instrument.

BC21. The IPSASB considered whether liabilities arising from non-exchange revenue transactions are financial liabilities. Liabilities are recognized in IPSAS 23 when an entity receives an inflow of resources that is subject to specific conditions. Conditions on a transfer of resources are imposed on an entity by a transferor and require that the resources are used in a certain way, often to provide goods and services to third parties, or are returned to the transferor. This gives rise to an obligation to perform in terms of the agreement. At initial recognition, an entity recognizes the resources as an asset and, where they are subject to conditions, recognizes a corresponding liability.

BC22. The IPSASB considered whether the liability initially recognized is in the nature of a financial liability or another liability, e.g., a provision. The IPSASB agreed that, at the time the asset is recognized, the liability is not usually a financial liability as the entity's obligation is to fulfil the terms and conditions of the arrangement by utilizing the resources as intended, usually by providing goods and services to third parties over a period of time. If after initial recognition, the entity cannot fulfil the terms of the arrangement and is required to return the resources to the transferor, an entity would assess at this stage whether the liability is a financial liability considering the requirements set out in paragraph BC18 and the definitions of a financial instrument and a financial liability. In rare circumstances, a financial liability may arise from conditions imposed on a transfer of resources as part of a non-exchange revenue transaction. The IPSASB may consider such a scenario as part of a future project.

BC23. The IPSASB also noted that other liabilities may arise from non-exchange revenue transactions after initial recognition. For example, an entity may receive resources under an arrangement that requires the resources to be

returned only after the occurrence or non-occurrence of a future event. An entity assesses whether other liabilities arising from non-exchange revenue transactions are financial liabilities by considering whether the requirements in paragraph BC18 have been fulfilled and the definitions of a financial instrument and a financial liability have been met.

Other

Interpretations Developed by the International Financial Reporting Interpretations Committee

- BC24. The IPSASB considered whether International Financial Reporting Interpretations Committee Interpretation (IFRIC) 2, *Members' Shares in Co-operative Entities and Similar Instruments* and International Financial Reporting Interpretations Committee Interpretation (IFRIC) 11, *IFRS 2—Group and Treasury Share Transactions* were relevant for the types of instruments entered into by governments and entities in the public sector.
- BC25. The IPSASB considered that IFRIC 11 is not relevant for the types of instruments entered into in the public sector as it deals with share-based payment transactions. While share-based payments may be common in Government Business Enterprises (GBE's), they do not occur frequently in entities that are not GBE's. As a result, the IPSASB has not included any principles from IFRIC 11 in IPSAS 28.
- BC26. IFRIC 2 provides guidance on the application of IAS 32 to members' shares in co-operative entities and similar instruments. There is a strong link between IAS 32 and IFRIC 2 in relation to puttable financial instruments and obligations arising on liquidation. As the text of IAS 32 that deals with puttable financial instruments and obligations arising on liquidation has been retained in IPSAS 28, IFRIC 2 provides additional guidance to users of IPSAS 28 in applying those principles to members' interests in co-operative entities. Therefore, the principles and examples from IFRIC 2 have been included in IPSAS 28 as an authoritative appendix.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 28.

Accounting for Contracts on Equity Instruments of an Entity

- IE1. The following examples illustrate the application of paragraphs 13–32 and IPSAS 29 to the accounting for contracts on an entity's own equity instruments. In these examples, monetary amounts are denominated in “currency units” (CU).

Example 1: Forward to Buy Shares

- IE2. This example illustrates the journal entries for forward purchase contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (i.e., the “carry return” is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

Contract date	February 1, 20X2
Maturity date	January 31, 20X3
Market price per share on February, 1 20X2	CU100
Market price per share on December, 31 20X2	CU110
Market price per share on January, 31 20X3	CU106
Fixed forward price to be paid on January, 31 20X3	CU104
Present value of forward price on February, 1 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on February, 1 20X2	CU0
Fair value of forward on December, 31 20X2	CU6,300
Fair value of forward on January, 31 20X3	CU2,000

(a) Cash for Cash (“Net Cash Settlement”)

- IE3. In this subsection, the forward purchase contract on the entity's own shares will be settled net in cash, i.e., there is no receipt or delivery of the entity's own shares upon settlement of the forward contract.

On February 1, 20X2, Entity A enters into a contract with Entity B to receive the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X3 in exchange for a payment of CU104,000 in cash (i.e.,

CU104 per share) on January 31, 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

February 1, 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the forward contract on February 1, 20X2 is zero.

No entry is required because the fair value of the derivative is zero and no cash is paid or received.

December 31, 20X2

On December 31, 20X2, the market price per share has increased to CU110 and, as a result, the fair value of the forward contract has increased to CU6,300.

Dr	Forward asset	CU6,300	
	Cr Gain		CU6,300

To record the increase in the fair value of the forward contract.

January 31, 20X3

On January 31, 20X3, the market price per share has decreased to CU106. The fair value of the forward contract is CU2,000 ($[(CU106 \times 1,000) - CU104,000]$).

On the same day, the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 to Entity B and Entity B has an obligation to deliver CU106,000 ($CU106 \times 1,000$) to Entity A, so Entity B pays the net amount of CU2,000 to Entity A.

Dr	Loss	CU4,300	
	Cr Forward asset		CU4,300

To record the decrease in the fair value of the forward contract (i.e., $CU4,300 = CU6,300 - CU2,000$).

Dr	Cash	CU2,000	
	Cr Forward asset		CU2,000

To record the settlement of the forward contract.

(b) Shares for Shares (“Net Share Settlement”)

- IE4. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A’s journal entries are the same as those shown in (a) above, except for recording the settlement of the forward contract, as follows:

January 31, 20X3

The contract is settled net in shares. Entity A has an obligation to deliver CU104,000 ($\text{CU104} \times 1,000$) worth of its shares to Entity B and Entity B has an obligation to deliver CU106,000 ($\text{CU106} \times 1,000$) worth of shares to Entity A. Thus, Entity B delivers a net amount of CU2,000 ($\text{CU106,000} - \text{CU104,000}$) worth of shares to Entity A, i.e., 18.9 shares ($\text{CU2,000}/\text{CU106}$).

Dr	Net assets/equity	CU2,000	
	Cr	Forward asset	CU2,000

To record the settlement of the forward contract.

(c) Cash for Shares (“Gross Physical Settlement”)

- IE5. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of Entity A’s shares. Similarly to (a) and (b) above, the price per share that Entity A will pay in one year is fixed at CU104. Accordingly, Entity A has an obligation to pay CU104,000 in cash to Entity B ($\text{CU104} \times 1,000$) and Entity B has an obligation to deliver 1,000 of Entity A’s outstanding shares to Entity A in one year. Entity A records the following journal entries.

February 1, 20X2

Dr	Net assets/equity	CU100,000	
	Cr	Liability	CU100,000

To record the obligation to deliver CU104,000 in one year at its present value of CU100,000 discounted using an appropriate interest rate (see IPSAS 29, paragraph AG82).

December 31, 20X2

Dr	Interest expense	CU3,660	
	Cr	Liability	CU3,660

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

January 31, 20X3

Dr	Interest expense	CU340	
	Cr	Liability	CU340

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

Entity A delivers CU104,000 in cash to Entity B and Entity B delivers 1,000 of Entity A’s shares to Entity A.

Dr	Liability	CU104,000	
	Cr	Cash	CU104,000

To record the settlement of the obligation to redeem Entity A’s own shares for cash.

(d) Settlement Options

- IE6. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the forward repurchase contract is a financial asset or a financial liability. If one of the settlement alternatives is to exchange cash for shares ((c) above), Entity A recognizes a liability for the obligation to deliver cash, as illustrated in (c) above. Otherwise, Entity A accounts for the forward contract as a derivative.

Example 2: Forward to Sell Shares

- IE7. This example illustrates the journal entries for forward sale contracts on an entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by receiving cash in exchange for shares. It also discusses the effect of settlement options (see (d) below). To simplify the illustration, it is assumed that no dividends are paid on the underlying shares (i.e., the "carry return" is zero) so that the present value of the forward price equals the spot price when the fair value of the forward contract is zero. The fair value of the forward has been computed as the difference between the market share price and the present value of the fixed forward price.

Assumptions:

Contract date	February 1, 20X2
Maturity date	January 31, 20X3
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU110
Market price per share on January 31, 20X3	CU106
Fixed forward price to be paid on January 31, 20X3	CU104
Present value of forward price on February 1, 20X2	CU100
Number of shares under forward contract	1,000
Fair value of forward on February 1, 20X2	CU0
Fair value of forward on December 31, 20X2	(CU6,300)
Fair value of forward on January 31, 20X3	(CU2,000)

(a) Cash for Cash ("Net Cash Settlement")

- IE8. On February 1, 20X2, Entity A enters into a contract with Entity B to pay the fair value of 1,000 of Entity A's own outstanding ordinary shares as of January 31, 20X3 in exchange for CU104,000 in cash (i.e., CU104 per share) on January 31, 20X3. The contract will be settled net in cash. Entity A records the following journal entries.

February 1, 20X2

No entry is required because the fair value of the derivative is zero and no cash is paid or received.

December 31, 20X2

Dr	Loss	CU6,300	
	Cr Forward liability		CU6,300

To record the decrease in the fair value of the forward contract.

January 31, 20X3

Dr	Forward liability	CU4,300	
	Cr Gain		CU4,300

To record the increase in the fair value of the forward contract (i.e., $CU4,300 = CU6,300 - CU2,000$).

The contract is settled net in cash. Entity B has an obligation to deliver CU104,000 to Entity A, and Entity A has an obligation to deliver CU106,000 ($CU106 \times 1,000$) to Entity B. Thus, Entity A pays the net amount of CU2,000 to Entity B.

Dr	Forward liability	CU2,000	
	Cr Cash		CU2,000

To record the settlement of the forward contract.

(b) Shares for Shares (“Net Share Settlement”)

- IE9. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A’s journal entries are the same as those shown in (a), except:

January 31, 20X3

The contract is settled net in shares. Entity A has a right to receive CU104,000 ($CU104 \times 1,000$) worth of its shares and an obligation to deliver CU106,000 ($CU106 \times 1,000$) worth of its shares to Entity B. Thus, Entity A delivers a net amount of CU2,000 ($CU106,000 - CU104,000$) worth of its shares to Entity B, i.e., 18.9 shares ($CU2,000/CU106$).

Dr	Forward liability	CU2,000	
	Cr Net assets/equity		CU2,000

To record the settlement of the forward contract. The issue of the entity’s own shares is treated as a transaction in net assets/equity.

(c) Shares for Cash (“Gross Physical Settlement”)

- IE10. Assume the same facts as in (a), except that settlement will be made by receiving a fixed amount of cash and delivering a fixed number of the entity’s own shares. Similarly to (a) and (b) above, the price per share that Entity A

will pay in one year is fixed at CU104. Accordingly, Entity A has a right to receive CU104,000 in cash ($\text{CU104} \times 1,000$) and an obligation to deliver 1,000 of its own shares in one year. Entity A records the following journal entries.

February 1, 20X2

No entry is made on February 1. No cash is paid or received because the forward has an initial fair value of zero. A forward contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash or another financial asset meets the definition of an equity instrument because it cannot be settled otherwise than through the delivery of shares in exchange for cash.

December 31, 20X2

No entry is made on December 31, because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X3

On January 31, 20X3, Entity A receives CU104,000 in cash and delivers 1,000 shares.

Dr	Cash	CU104,000	
	Cr	Net assets/equity	CU104,000

To record the settlement of the forward contract.

(d) Settlement Options

- IE11. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the forward contract is a financial asset or a financial liability. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A repurchasing a fixed number of its own shares in exchange for paying a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset or liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 3: Purchased Call Option on Shares

- IE12. This example illustrates the journal entries for a purchased call option right on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for the entity's own shares. It also discusses the effect of settlement options (see (d) below):

Assumptions:

Contract date	February 1, 20X2
Exercise date	January 31, 20X3
	(European terms, i.e., it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU104
Market price per share on January 31, 20X3	CU104
Fixed exercise price to be paid on January 31, 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on February 1, 20X2	CU5,000
Fair value of option on December 31, 20X2	CU3,000
Fair value of option on January 31, 20X3	CU2,000

(a) Cash for Cash (“Net Cash Settlement”)

- IE13. On February 1, 20X2, Entity A enters into a contract with Entity B that gives Entity B the obligation to deliver, and Entity A the right to receive the fair value of 1,000 of Entity A’s own ordinary shares as of January 31, 20X3 in exchange for CU102,000 in cash (i.e., CU102 per share) on January 31, 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the option contract on February 1, 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU102 exceeds the market price per share of CU100 and it would therefore not be economic for Entity A to exercise the option. In other words, the call option is out of the money.

Dr	Call option asset	CU5,000	
	Cr	Cash	CU5,000

To recognize the purchased call option.

December 31, 20X2

On December 31, 20X2, the market price per share has increased to CU104. The fair value of the call option has decreased to CU3,000, of which CU2,000 is intrinsic value $[(CU104 - CU102) \times 1,000]$, and CU1,000 is the remaining time value.

Dr	Loss	CU2,000	
	Cr	Call option asset	CU2,000

To record the decrease in the fair value of the call option.

January 31, 20X3

On January 31, 20X3, the market price per share is still CU104. The fair value of the call option has decreased to CU2,000, which is all intrinsic value $[(CU104 - CU102) \times 1,000]$ because no time value remains.

Dr	Loss	CU1,000	
	Cr	Call option asset	CU1,000

To record the decrease in the fair value of the call option.

On the same day, Entity A exercises the call option and the contract is settled net in cash. Entity B has an obligation to deliver CU104,000 $(CU104 \times 1,000)$ to Entity A in exchange for CU102,000 $(CU102 \times 1,000)$ from Entity A, so Entity A receives a net amount of CU2,000.

Dr	Cash	CU2,000	
	Cr	Call option asset	CU2,000

To record the settlement of the option contract.

(b) Shares for Shares (“Net Share Settlement”)

- IE14. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A’s journal entries are the same as those shown in (a) except for recording the settlement of the option contract as follows:

January 31, 20X3

Entity A exercises the call option and the contract is settled net in shares. Entity B has an obligation to deliver CU104,000 $(CU104 \times 1,000)$ worth of Entity A’s shares to Entity A in exchange for CU102,000 $(CU102 \times 1,000)$ worth of Entity A’s shares. Thus, Entity B delivers the net amount of CU2,000 worth of shares to Entity A, i.e., 19.2 shares $(CU2,000/CU104)$.

Dr	Net assets/equity	CU2,000	
	Cr	Call option asset	CU2,000

To record the settlement of the option contract. The settlement is accounted for as a treasury share transaction (i.e., no gain or loss).

(c) Cash for Shares (“Gross Physical Settlement”)

- IE15. Assume the same facts as in (a) except that settlement will be made by receiving a fixed number of shares and paying a fixed amount of cash, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity A has a right to receive 1,000 of Entity A’s own outstanding shares in exchange for CU102,000 ($\text{CU102} \times 1,000$) in cash, if Entity A exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr	Net assets/equity	CU5,000	
	Cr Cash		CU5,000

To record the cash paid in exchange for the right to receive Entity A’s own shares in one year for a fixed price. The premium paid is recognized in net assets/equity.

December 31, 20X2

No entry is made on December 31, because no cash is paid or received and a contract that gives a right to receive a fixed number of Entity A’s own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X3

Entity A exercises the call option and the contract is settled gross. Entity B has an obligation to deliver 1,000 of Entity A’s shares in exchange for CU102,000 in cash.

Dr	Net assets/equity	CU102,000	
	Cr Cash		CU102,000

To record the settlement of the option contract.

(d) Settlement Options

- IE16. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the call option is a financial asset. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A repurchasing a fixed number of its own shares in exchange for paying a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 4: Written Call Option on Shares

- IE17. This example illustrates the journal entries for a written call option obligation on the entity’s own shares that will be settled (a) net in cash, (b) net in shares,

or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date	February 1, 20X2
Exercise date	January 31, 20X3
	(European terms, i.e., it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU104
Market price per share on January 31, 20X3	CU104
Fixed exercise price to be paid on January 31, 20X3	CU102
Number of shares under option contract	1,000
Fair value of option on February 1, 20X2	CU5,000
Fair value of option on December 31, 20X2	CU3,000
Fair value of option on January 31, 20X3	CU2,000

(a) Cash for Cash (“Net Cash Settlement”)

IE18. Assume the same facts as in Example 3(a) above except that Entity A has written a call option on its own shares instead of having purchased a call option on them. Accordingly, on February 1, 20X2 Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A’s own ordinary shares as of January 31, 20X3 in exchange for CU102,000 in cash (i.e., CU102 per share) on January 31, 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

Dr	Cash	CU5,000	
	Cr	Call option obligation	CU5,000

To recognize the written call option.

December 31, 20X2

Dr	Call option obligation	CU2,000	
	Cr Gain		CU2,000

To record the decrease in the fair value of the call option.

January 31, 20X3

Dr	Call option obligation	CU1,000	
	Cr Gain		CU1,000

To record the decrease in the fair value of the option.

On the same day, Entity B exercises the call option and the contract is settled net in cash. Entity A has an obligation to deliver CU104,000 ($\text{CU104} \times 1,000$) to Entity B in exchange for CU102,000 ($\text{CU102} \times 1,000$) from Entity B, so Entity A pays a net amount of CU2,000.

Dr	Call option obligation	CU2,000	
	Cr Cash		CU2,000

To record the settlement of the option contract.

(b) Shares for Shares (“Net Share Settlement”)

- IE19. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A’s journal entries are the same as those shown in (a), except for recording the settlement of the option contract, as follows:

December 31, 20X3

Entity B exercises the call option and the contract is settled net in shares. Entity A has an obligation to deliver CU104,000 ($\text{CU104} \times 1,000$) worth of Entity A’s shares to Entity B in exchange for CU102,000 ($\text{CU102} \times 1,000$) worth of Entity A’s shares. Thus, Entity A delivers the net amount of CU2,000 worth of shares to Entity B, i.e., 19.2 shares ($\text{CU2,000}/\text{CU104}$).

Dr	Call option obligation	CU2,000	
	Cr Net assets/equity		CU2,000

To record the settlement of the option contract. The settlement is accounted for as a transaction in net assets/equity.

(c) Cash for Shares (“Gross Physical Settlement”)

- IE20. Assume the same facts as in (a) except that settlement will be made by delivering a fixed number of shares and receiving a fixed amount of cash, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU102. Accordingly, Entity B has a right to receive 1,000 of Entity A’s own outstanding shares in exchange for CU102,000 ($\text{CU102} \times 1,000$) in cash, if Entity B exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr	Cash	CU5,000	
	Cr	Net assets/equity	CU5,000

To record the cash received in exchange for the obligation to deliver a fixed number of Entity A's own shares in one year for a fixed price. The premium received is recognized in net assets/equity. Upon exercise, the call would result in the issue of a fixed number of shares in exchange for a fixed amount of cash.

December 31, 20X2

No entry is made on December 31 because no cash is paid or received and a contract to deliver a fixed number of Entity A's own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of the entity.

January 31, 20X3

Entity B exercises the call option and the contract is settled gross. Entity A has an obligation to deliver 1,000 shares in exchange for CU102,000 in cash.

Dr	Cash	CU102,000	
	Cr	Net assets/equity	CU102,000

To record the settlement of the option contract.

(d) Settlement Options

- IE21. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the call option is a financial liability. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A issuing a fixed number of its own shares in exchange for receiving a fixed amount of cash or another financial asset. Entity A recognizes a derivative liability, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 5: Purchased Put Option on Shares

- IE22. This example illustrates the journal entries for a purchased put option on the entity's own shares that will be settled (a) net in cash, (b) net in shares, or (c) by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date	February 1, 20X2
Exercise date	January 31, 20X3 (European terms, i.e., it can be exercised only at maturity)
Exercise right holder	Reporting entity (Entity A)
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU95
Market price per share on January 31, 20X3	CU95
Fixed exercise price to be paid on January 31, 20X3	CU98
Number of shares under option contract	1,000
Fair value of option on February 1, 20X2	CU5,000
Fair value of option on December 31, 20X2	CU4,000
Fair value of option on January 31, 20X3	CU3,000

(a) Cash for Cash (“Net Cash Settlement”)

- IE23. On February 1, 20X2, Entity A enters into a contract with Entity B that gives Entity A the right to sell, and Entity B the obligation to buy the fair value of 1,000 of Entity A’s own outstanding ordinary shares as of January 31, 20X3 at a strike price of CU98,000 (i.e., CU98 per share) on January 31, 20X3, if Entity A exercises that right. The contract will be settled net in cash. If Entity A does not exercise its right, no payment will be made. Entity A records the following journal entries.

February, 1 20X2

The price per share when the contract is agreed on February 1, 20X2 is CU100. The initial fair value of the option contract on February 1, 20X2 is CU5,000, which Entity A pays to Entity B in cash on that date. On that date, the option has no intrinsic value, only time value, because the exercise price of CU98 is less than the market price per share of CU100. Therefore it would not be economic for Entity A to exercise the option. In other words, the put option is out of the money.

Dr	Put option asset	CU5,000	
	Cr	Cash	CU5,000

To recognize the purchased put option.

December 31, 20X2

On December 31, 20X2 the market price per share has decreased to CU95. The fair value of the put option has decreased to CU4,000, of which CU3,000 is intrinsic value ($[\text{CU}98 - \text{CU}95] \times 1,000$) and CU1,000 is the remaining time value.

Dr	Loss	CU1,000	
	Cr	Put option asset	CU1,000

To record the decrease in the fair value of the put option.

January 31, 20X3

On January 31, 20X3 the market price per share is still CU95. The fair value of the put option has decreased to CU3,000, which is all intrinsic value ($[\text{CU}98 - \text{CU}95] \times 1,000$) because no time value remains.

Dr	Loss	CU1,000	
	Cr	Put option asset	CU1,000

To record the decrease in the fair value of the option.

On the same day, Entity A exercises the put option and the contract is settled net in cash. Entity B has an obligation to deliver CU98,000 to Entity A and Entity A has an obligation to deliver CU95,000 ($\text{CU}95 \times 1,000$) to Entity B, so Entity B pays the net amount of CU3,000 to Entity A.

Dr	Cash	CU3,000	
	Cr	Put option asset	CU3,000

To record the settlement of the option contract.

(b) Shares for Shares (“Net Share Settlement”)

- IE24. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A’s journal entries are the same as shown in (a), except:

January 31, 20X3

Entity A exercises the put option and the contract is settled net in shares. In effect, Entity B has an obligation to deliver CU98,000 worth of Entity A’s shares to Entity A, and Entity A has an obligation to deliver CU95,000 worth of Entity A’s shares ($\text{CU}95 \times 1,000$) to Entity B, so Entity B delivers the net amount of CU3,000 worth of shares to Entity A, i.e., 31.6 shares ($\text{CU}3,000/\text{CU}95$).

Dr	Net assets/equity	CU3,000	
	Cr	Put option asset	CU3,000

To record the settlement of the option contract.

(c) Cash for Shares (“Gross Physical Settlement”)

- IE25. Assume the same facts as in (a) except that settlement will be made by receiving a fixed amount of cash and delivering a fixed number of Entity A’s shares, if Entity A exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU98. Accordingly, Entity B has an obligation to pay CU98,000 in cash to Entity A ($\text{CU98} \times 1,000$) in exchange for 1,000 of Entity A’s outstanding shares, if Entity A exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr	Net assets/equity	CU5,000	
	Cr	Cash	CU5,000

To record the cash received in exchange for the right to deliver Entity A’s own shares in one year for a fixed price. The premium paid is recognized directly in net assets/equity. Upon exercise, it results in the issue of a fixed number of shares in exchange for a fixed price.

December 31, 20X2

No entry is made on December 31, because no cash is paid or received and a contract to deliver a fixed number of Entity A’s own shares in exchange for a fixed amount of cash meets the definition of an equity instrument of Entity A.

January 31, 20X3

Entity A exercises the put option and the contract is settled gross. Entity B has an obligation to deliver CU98,000 in cash to Entity A in exchange for 1,000 shares.

Dr	Cash	CU98,000	
	Cr	Net assets/equity	CU98,000

To record the settlement of the option contract.

(d) Settlement Options

- IE26. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the put option is a financial asset. It does not meet the definition of an equity instrument because it can be settled otherwise than by Entity A issuing a fixed number of its own shares in exchange for receiving a fixed amount of cash or another financial asset. Entity A recognizes a derivative asset, as illustrated in (a) and (b) above. The accounting entry to be made on settlement depends on how the contract is actually settled.

Example 6: Written Put Option on Shares

- IE27. This example illustrates the journal entries for a written put option on the entity’s own shares that will be settled (a) net in cash, (b) net in shares, or (c)

by delivering cash in exchange for shares. It also discusses the effect of settlement options (see (d) below).

Assumptions:

Contract date	February 1, 20X2
Exercise date	January 31, 20X3
	(European terms, i.e., it can be exercised only at maturity)
Exercise right holder	Counterparty (Entity B)
Market price per share on February 1, 20X2	CU100
Market price per share on December 31, 20X2	CU95
Market price per share on January 31, 20X3	CU95
Fixed exercise price to be paid on January 31, 20X3	CU98
Present value of exercise price on February 1, 20X2	CU95
Number of shares under option contract	1,000
Fair value of option on February 1, 20X2	CU5,000
Fair value of option on December 31, 20X2	CU4,000
Fair value of option on January 31, 20X3	CU3,000

(a) Cash for Cash (“Net Cash Settlement”)

- IE28. Assume the same facts as in Example 5(a) above, except that Entity A has written a put option on its own shares instead of having purchased a put option on its own shares. Accordingly, on February, 1 20X2, Entity A enters into a contract with Entity B that gives Entity B the right to receive and Entity A the obligation to pay the fair value of 1,000 of Entity A’s outstanding ordinary shares as of January 31, 20X3 in exchange for CU98,000 in cash (i.e., CU98 per share) on January 31, 20X3, if Entity B exercises that right. The contract will be settled net in cash. If Entity B does not exercise its right, no payment will be made. Entity A records the following journal entries.

February 1, 20X2

Dr	Cash	CU5,000	
	Cr	Put option liability	CU5,000

To recognize the written put option.

December 31, 20X2

Dr	Put option liability	CU1,000	
	Cr Gain		CU1,000

To record the decrease in the fair value of the put option.

January 31, 20X3

Dr	Put option liability	CU1,000	
	Cr Gain		CU1,000

To record the decrease in the fair value of the put option.

On the same day, Entity B exercises the put option and the contract is settled net in cash. Entity A has an obligation to deliver CU98,000 to Entity B, and Entity B has an obligation to deliver CU95,000 ($\text{CU}95 \times 1,000$) to Entity A. Thus, Entity A pays the net amount of CU3,000 to Entity B.

Dr	Put option liability	CU3,000	
	Cr Cash		CU3,000

To record the settlement of the option contract.

(b) Shares for Shares (“Net Share Settlement”)

- IE29. Assume the same facts as in (a) except that settlement will be made net in shares instead of net in cash. Entity A’s journal entries are the same as those in (a), except for the following:

January 31, 20X3

Entity B exercises the put option and the contract is settled net in shares. In effect, Entity A has an obligation to deliver CU98,000 worth of shares to Entity B, and Entity B has an obligation to deliver CU95,000 worth of Entity A’s shares ($\text{CU}95 \times 1,000$) to Entity A. Thus, Entity A delivers the net amount of CU3,000 worth of Entity A’s shares to Entity B, i.e., 31.6 shares ($3,000/95$).

Dr	Put option liability	CU3,000	
	Cr Net assets/equity		CU3,000

To record the settlement of the option contract. The issue of Entity A’s own shares is accounted for as a transaction in net assets/equity.

(c) Cash for Shares (“Gross Physical Settlement”)

- IE30. Assume the same facts as in (a) except that settlement will be made by delivering a fixed amount of cash and receiving a fixed number of shares, if Entity B exercises the option. Similarly to (a) and (b) above, the exercise price per share is fixed at CU98. Accordingly, Entity A has an obligation to pay CU98,000 in cash to Entity B ($\text{CU}98 \times 1,000$) in exchange for 1,000 of Entity A’s outstanding shares, if Entity B exercises its option. Entity A records the following journal entries.

February 1, 20X2

Dr	Cash	CU5,000	
	Cr	Net assets/equity	CU5,000

To recognize the option premium received of CU5,000 in net assets/equity.

Dr	Net assets/equity	CU95,000	
	Cr	Liability	CU95,000

To recognize the present value of the obligation to deliver CU98,000 in one year, i.e., CU95,000, as a liability.

December 31, 20X2

Dr	Interest expense	CU2,750	
	Cr	Liability	CU2,750

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

January 31, 20X3

Dr	Interest expense	CU250	
	Cr	Liability	CU250

To accrue interest in accordance with the effective interest method on the liability for the share redemption amount.

On the same day, Entity B exercises the put option and the contract is settled gross. Entity A has an obligation to deliver CU98,000 in cash to Entity B in exchange for CU95,000 worth of shares ($CU95 \times 1,000$).

Dr	Liability	CU98,000	
	Cr	Cash	CU98,000

To record the settlement of the option contract.

(d) Settlement Options

- IE31. The existence of settlement options (such as net in cash, net in shares, or by an exchange of cash and shares) has the result that the written put option is a financial liability. If one of the settlement alternatives is to exchange cash for shares ((c) above), Entity A recognizes a liability for the obligation to deliver cash, as illustrated in (c) above. Otherwise, Entity A accounts for the put option as a derivative liability.

Entities such as Mutual Funds and Co-operatives Whose Share Capital is not Net Assets/Equity

Example 7: Entities with No Net Assets/Equity

- IE32. The following example illustrates a format of a statement of financial performance and statement of financial position that may be used by entities

such as mutual funds that do not have net assets/equity. Other formats are possible.

Statement of Financial Performance for the year ended December 31, 20X1

	20X1	20X0
	CU	CU
Revenue	2,956	1,718
Total Revenue	2,956	1,718
Expenses (classified by nature or function)	(644)	(614)
Finance costs		
— other finance costs	(47)	(47)
— distributions to unitholders	(50)	(50)
Total Expenses	(741)	(711)
Surplus for the year	2,215	1,007
Change in net assets attributable to unitholders	2,215	1,007

Statement of Financial Position at December 31, 20X1

	20X1	20X0
CU	CU	CU
ASSETS		
Non-current assets (classified in accordance with IPSAS 1)	91,374	78,484
Total non-current assets	91,374	78,484
Current assets (classified in accordance with IPSAS 1)	1,422	1,769
Total current assets	1,422	1,769
Total assets	92,796	80,253
LIABILITIES		
Current liabilities (classified in accordance with IPSAS 1)	647	66
Total current liabilities	(647)	(66)
Non-current liabilities excluding net assets attributable to unitholders (classified in accordance with IPSAS 1)	280	136
	(280)	(136)
Net assets attributable to unitholders	91,869	80,051

Example 8: Entities with Some Net Assets/Equity

IE33. The following example illustrates a format of a statement of financial performance and statement of financial position that may be used by entities whose share capital is not net assets/equity because the entity has an obligation to repay the share capital on demand. Other formats are possible.

Statement of Financial Performance for the year ended December 31, 20X1

	20X1	20X0
	CU	CU
Revenue	472	498
Total Revenue	<u>472</u>	<u>498</u>
Expenses (classified by nature or function)	(367)	(396)
Finance costs		
— other finance costs	(4)	(4)
— distributions to members	(50)	(50)
Total Expenses	<u>(421)</u>	<u>(450)</u>
Surplus for the year	<u>51</u>	<u>48</u>
Change in net assets attributable to members	<u>51</u>	<u>48</u>

Statement of Financial Position at December 31, 20X1

		20X1		20X0
	CU	CU	CU	CU
ASSETS				
Non-current assets (classified in accordance with IPSAS 1)	908		830	
Total non-current assets		908		830
Current assets (classified in accordance with IPSAS 1)	383		350	
Total current assets		383		350
Total assets		<u>1,291</u>		<u>1,180</u>
LIABILITIES				
Current liabilities (classified in accordance with IPSAS 1)	372		338	
Share capital repayable on demand	202		161	
Total current liabilities		(574)		(499)
Total assets less current liabilities		<u>717</u>		<u>681</u>
Non-current liabilities (classified in accordance with IPSAS 1)	187		196	
		(187)		(196)
OTHER COMPONENTS OF NET ASSETS/EQUITY^(a)				
Reserves, e.g., revaluation surplus, accumulated surplus, etc.	530		485	
		530		485
		<u>717</u>		<u>681</u>
MEMORANDUM NOTE – Total members' interests				
Share capital repayable on demand		202		161
Reserves		530		485
		<u>732</u>		<u>646</u>

(a) In this example, the entity has no obligation to deliver a share of its reserves to its members.

Accounting for Compound Financial Instruments*Example 9: Separation of a Compound Financial Instrument on Initial Recognition*

IE34. Paragraph 33 describes how the components of a compound financial instrument are separated by the entity on initial recognition. The following example illustrates how such a separation is made.

- IE35. An entity issues 2,000 convertible bonds at the start of year 1. The bonds have a three-year term, and are issued at par with a face value of CU1,000 per bond, giving total proceeds of CU2,000,000. Interest is payable annually in arrears at a nominal annual interest rate of 6 percent. Each bond is convertible at any time up to maturity into 250 ordinary shares. When the bonds are issued, the prevailing market interest rate for similar debt without conversion options is 9 percent.
- IE36. The liability component is measured first, and the difference between the proceeds of the bond issue and the fair value of the liability is assigned to the net assets/equity component. The present value of the liability component is calculated using a discount rate of 9 percent, the market interest rate for similar bonds having no conversion rights, as shown below.

	CU
Present value of the principal – CU2,000,000 payable at the end of three years	1,544,367
Present value of the interest – CU120,000 payable annually in arrears for three years	303,755
Total liability component	1,848,122
Net assets/equity component (by deduction)	151,878
Proceeds of the bond issue	2,000,000

Example 10: Separation of a Compound Financial Instrument with Multiple Embedded Derivative Features

- IE37. The following example illustrates the application of paragraph 36 to the separation of a compound financial instrument with multiple embedded derivative features into the liability and net assets/equity component.
- IE38. Assume that the proceeds received on the issue of a callable convertible bond are CU60. The value of a similar bond without a call or equity conversion option is CU57. Based on an option pricing model, it is determined that the value to the entity of the embedded call feature in a similar bond without an equity conversion option is CU2. In this case, the value allocated to the liability component under paragraph 36 is CU55 (CU57 – CU2) and the value allocated to the net assets/equity component is CU5 (CU60 – CU55).

Example 11: Repurchase of a Convertible Instrument

- IE39. The following example illustrates how an entity accounts for a repurchase of a convertible instrument. For simplicity, at inception, the face amount of the instrument is assumed to be equal to the aggregate carrying amount of the liability and the net assets/equity components in the financial statements, i.e., no original issue premium or discount exists. Also, for simplicity, tax considerations have been omitted from the example.

IE40. On January 1, 20X0, Entity A issued a 10 percent convertible debenture with a face value of CU1,000 maturing on December 31, 20X9. The debenture is convertible into ordinary shares of Entity A at a conversion price of CU25 per share. Interest is payable half-yearly in cash. At the date of issue, Entity A could have issued non-convertible debt with a ten-year term bearing a coupon interest rate of 11 percent.

IE41. In the financial statements of Entity A the carrying amount of the debenture was allocated on issue as follows:

	CU
Liability component	
Present value of 20 half-yearly interest payments of CU50, discounted at 11%	597
Present value of CU1,000 due in 10 years, discounted at 11%, compounded half-yearly	343
	<hr/> 940
Net assets/equity component	
(difference between CU1,000 total proceeds and CU940 allocated above)	60
Total proceeds	<hr/> <hr/> 1,000

IE42. On January 1, 20X5 the convertible debenture has a fair value of CU1,700.

IE43. Entity A makes a tender offer to the holder of the debenture to repurchase the debenture for CU1,700, which the holder accepts. At the date of repurchase, Entity A could have issued non-convertible debt with a five-year term bearing a coupon interest rate of 8 percent.

IE44. The repurchase price is allocated as follows:

	Carrying value	Fair value	Difference
Liability component:	CU	CU	CU
Present value of 10 remaining half-yearly interest payments of CU50, discounted at 11% and 8%, respectively	377	405	
Present value of CU1,000 due in 5 years, discounted at 11% and 8%, compounded half-yearly, respectively	585	676	
	962	1,081	(119)
Net assets/equity component	60	619 ^(a)	(559)
Total	1,022	1,700	(678)

(a) This amount represents the difference between the fair value amount allocated to the liability component and the repurchase price of CU1,700.

IE45. Entity A recognizes the repurchase of the debenture as follows:

Dr	Liability component	CU962	
Dr	Debt settlement expense (surplus or deficit)	CU119	
	Cr Cash		CU1,081

To recognize the repurchase of the liability component.

Dr	Net assets/equity	CU619	
	Cr Cash		CU619

To recognize the cash paid for the net assets/equity component.

IE46. The net assets/equity component remains as net assets/equity, but may be transferred from one line item within net assets/equity to another.

Example 12: Amendment of the Terms of a Convertible Instrument to Induce Early Conversion

IE47. The following example illustrates how an entity accounts for the additional consideration paid when the terms of a convertible instrument are amended to induce early conversion.

IE48. On January 1, 20X0, Entity A issued a 10 percent convertible debenture with a face value of CU1,000 with the same terms as described in Example 9. On January 1, 20X1, to induce the holder to convert the convertible debenture promptly, Entity A reduces the conversion price to CU20 if the debenture is converted before March 1, 20X1 (i.e., within 60 days).

IE49. Assume the market price of Entity A's ordinary shares on the date the terms are amended is CU40 per share. The fair value of the incremental consideration paid by Entity A is calculated as follows:

Number of ordinary shares to be issued to debenture holders under amended conversion terms:

Face amount	CU1,000	
New conversion price	/CU20	per share
Number of ordinary shares to be issued on conversion	<u>50</u>	shares

*Number of ordinary shares to be issued to debenture holders under **original** conversion terms:*

Face amount	CU1,000	
Original conversion price	/CU25	per share
Number of ordinary shares to be issued on conversion	<u>40</u>	Shares
<i>Number of incremental ordinary shares issued upon conversion</i>	10	Shares

*Value of **incremental** ordinary shares issued upon conversion*

CU40 per share x 10 incremental shares	<u>CU400</u>
--	--------------

IE50. The incremental consideration of CU400 is recognized as a loss in surplus or deficit.

Comparison with IAS 32

IPSAS 28, *Financial Instruments: Presentation* is drawn primarily from IAS 32, *Financial Instruments: Presentation* (issued originally in 2003, including amendments up to December 31, 2008). The main differences between IPSAS 28 and IAS 32 are as follows:

- IAS 32 allows entities to treat financial guarantee contracts as insurance contracts where entities have previously asserted that such contracts are insurance contracts. IPSAS 28 allows a similar election, except that entities need not have explicitly asserted that financial guarantees are insurance contracts.
- In certain instances, IPSAS 28 uses different terminology from IAS 32. The most significant examples are the use of the terms “statement of financial performance” and “net assets/equity.” The equivalent terms in IAS 32 are “statement of comprehensive income or separate income statement (if presented)” and “equity.”
- IPSAS 28 does not distinguish between “revenue” and “income.” IAS 32 distinguishes between “revenue” and “income,” with “income” having a broader meaning than the term “revenue.”
- IPSAS 28 contains additional Application Guidance dealing with the identification of arrangements that are, in substance, contractual.
- IPSAS 28 contains additional Application Guidance on when assets and liabilities arising from non-exchange revenue transactions are financial assets or financial liabilities.
- Principles from IFRIC 2, *Members’ Shares in Co-operative Entities and Similar Instruments* have been included as an Appendix in IPSAS 28.
- The transitional provisions in IPSAS 28 differ from those in IAS 32. This is because IPSAS 28 provides transitional provisions for those entities applying this Standard for the first time or those applying accrual accounting for the first time.

IPSAS 29—FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 39, *Financial Instruments: Recognition and Measurement*, International Financial Reporting Interpretations Committee (IFRIC) Interpretation 9, *Reassessment of Embedded Derivatives*, (IFRIC 9) and Interpretation 16 (IFRIC 16) of the IFRIC, *Hedges of a Net Investment in a Foreign Operation* published by the International Accounting Standards Board (IASB). Extracts from IAS 39, IFRIC 9, and IFRIC 16 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IFRSs, IASs, Exposure Drafts, and other publications of the IASB are copyright of the IFRS Foundation.

“IFRS,” “IAS,” “IASB,” “IFRS Foundation,” “International Accounting Standards,” and “International Financial Reporting Standards” are trademarks of the IFRS Foundation and should not be used without the approval of the IFRS Foundation.

IPSAS 29—FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 15, 2014.

IPSAS 29, *Financial Instruments: Recognition and Measurement* was issued in January 2010.

Since then, IPSAS 29 has been amended by the following IPSASs:

- IPSAS 32, *Service Concession Arrangements: Grantor* (issued October 2011)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 29

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
2	Amended	IPSAS 32 October 2011
125A	New	IPSAS 32 October 2011

IPSAS 29—FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

CONTENTS

	Paragraph
Objective	1
Scope	2–8
Definitions	9–10
Embedded Derivatives	11–15
Recognition and Derecognition	16–44
Initial Recognition	16
Derecognition of a Financial Asset	17–37
Transfers that Qualify for Derecognition	26–30
Transfers that do not Qualify for Derecognition	31
Continuing Involvement in Transferred Assets	32–37
All Transfers	38–39
Regular Way Purchases and Sales of a Financial Asset	40
Derecognition of a Financial Liability	41–44
Measurement	45–79
Initial Measurement of Financial Assets and Financial Liabilities	45–46
Subsequent Measurement of Financial Assets	47–48
Subsequent Measurement of Financial Liabilities	49
Fair Value Considerations	50–52
Reclassifications	53–63
Gains and Losses	64–66
Impairment and Uncollectibility of Financial Assets	67–79
Financial Assets Carried at Amortized Cost	72–74
Financial Assets Carried at Cost	75
Available-For-Sale Financial Assets	76–79
Hedging	80–113

Hedging Instruments	81–86
Qualifying Hedging Instruments	81–82
Designation of Hedging Instruments	83–86
Hedged Items	87–94
Qualifying Items	87–89
Designation of Financial Items as Hedged Items	90–91
Designation of Non-Financial Items as Hedged Items	92
Designation of Groups of Items as Hedged Items	93–94
Hedge Accounting	95–113
Fair Value Hedges	99–105
Cash Flow Hedges	106–112
Hedges of a Net Investment	113
Transition	114–123
Effective Date	124–126
Appendix A: Application Guidance	
Appendix B: Reassessment of Embedded Derivatives	
Appendix C: Hedges of a Net Investment in a Foreign Operation	
Appendix D: Amendments to Other IPSASs	
Basis for Conclusions	
Implementation Guidance	
Illustrative Examples	
Comparison with IAS 39	

International Public Sector Accounting Standard 29, *Financial Instruments: Recognition and Measurement*, is set out in paragraphs 1–126. All the paragraphs have equal authority. IPSAS 29 should be read in the context of its objective, the Basis for Conclusions, and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to establish principles for recognizing and measuring financial assets, financial liabilities and some contracts to buy or sell non-financial items. Requirements for presenting information about financial instruments are in IPSAS 28, *Financial Instruments: Presentation*. Requirements for disclosing information about financial instruments are in IPSAS 30, *Financial Instruments: Disclosures*.

Scope

2. **This Standard shall be applied by all entities to all types of financial instruments, except:**
 - (a) **Those interests in controlled entities, associates and joint ventures that are accounted for under IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates*, or IPSAS 8, *Interests in Joint Ventures*. However, entities shall apply this Standard to an interest in a controlled entity, associate, or joint venture that according to IPSAS 6, IPSAS 7, or IPSAS 8 is accounted for under this Standard. Entities shall also apply this Standard to derivatives on an interest in a controlled entity, associate, or joint venture unless the derivative meets the definition of an equity instrument of the entity in IPSAS 28.**
 - (b) **Rights and obligations under leases to which IPSAS 13, *Leases* applies. However:**
 - (i) **Lease receivables recognized by a lessor are subject to the derecognition and impairment provisions of this Standard (see paragraphs 17–39, 67, 68, 72, and Appendix A paragraphs AG51–AG67 and AG117–AG126);**
 - (ii) **Finance lease payables recognized by a lessee are subject to the derecognition provisions of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80); and**
 - (iii) **Derivatives that are embedded in leases are subject to the embedded derivatives provisions of this Standard (see paragraphs 11–15 and Appendix A paragraphs AG40–AG46).**
 - (c) **Employers' rights and obligations under employee benefit plans, to which IPSAS 25, *Employee Benefits* applies.**
 - (d) **Financial instruments issued by the entity that meet the definition of an equity instrument in IPSAS 28 (including options and warrants) or that are required to be classified as an equity**

instrument in accordance with paragraphs 15 and 16 or 17 and 18 of IPSAS 28. However, the holder of such equity instruments shall apply this Standard to those instruments, unless they meet the exception in (a) above.

- (e) **Rights and obligations arising under:**
 - (i) **An insurance contract, other than an issuer's rights and obligations arising under an insurance contract that meets the definition of a financial guarantee contract in paragraph 10; or**
 - (ii) **A contract that is within the scope of the relevant international or national accounting standard dealing with insurance contracts because it contains a discretionary participation feature.**

This Standard applies to a derivative that is embedded in an insurance contract if the derivative is not itself an insurance contract (see paragraphs 11–15 and Appendix A paragraphs AG40–AG46 of this Standard). An entity applies this Standard to financial guarantee contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply that standard in recognizing and measuring them. Notwithstanding (i) above, an entity may apply this Standard to other insurance contracts which involve the transfer of financial risk.

- (f) **Any forward contracts between an acquirer and seller to buy or sell an acquiree that will result in an entity combination at a future acquisition date. The term of the forward contract should not exceed a reasonable period normally necessary to obtain any required approvals and to complete the transaction.**
- (g) **Loan commitments other than those loan commitments described in paragraph 4. An issuer of loan commitments shall apply IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* to loan commitments that are not within the scope of this Standard. However, all loan commitments are subject to the derecognition provisions of this Standard (see paragraphs 17–44 and Appendix A paragraphs AG51–AG80).**
- (h) **Financial instruments, contracts and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share based payment applies, except for contracts within the scope of paragraphs 4–6 of this Standard, to which this Standard applies.**

- (i) **Rights to payments to reimburse the entity for expenditure it is required to make to settle a liability that it recognizes as a provision in accordance with IPSAS 19, or for which, in an earlier period, it recognized a provision in accordance with IPSAS 19.**
 - (j) **The initial recognition and initial measurement of rights and obligations arising from non-exchange revenue transactions, to which IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* applies.**
 - (k) **Rights and obligations under service concession arrangements to which IPSAS 32, *Service Concession Assets: Grantor* applies. However, financial liabilities recognized by a grantor under the financial liability model are subject to the derecognition provisions of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80).**
3. **The following loan commitments are within the scope of this Standard:**
- (a) **Loan commitments that the entity designates as financial liabilities at fair value through surplus or deficit. An entity that has a past practice of selling the assets resulting from its loan commitments shortly after origination shall apply this Standard to all its loan commitments in the same class.**
 - (b) **Loan commitments that can be settled net in cash or by delivering or issuing another financial instrument. These loan commitments are derivatives. A loan commitment is not regarded as settled net merely because the loan is paid out in installments (e.g., a mortgage construction loan that is paid out in installments in line with the progress of construction).**
 - (c) **Commitments to provide a loan at a below-market interest rate. Paragraph 49(d) specifies the subsequent measurement of liabilities arising from these loan commitments.**
4. **This Standard shall be applied to those contracts to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the exception of contracts that were entered into and continue to be held for the purpose of the receipt or delivery of a non-financial item in accordance with the entity's expected purchase, sale, or usage requirements.**
5. **There are various ways in which a contract to buy or sell a non-financial item can be settled net in cash or another financial instrument or by exchanging financial instruments. These include:**

- (a) When the terms of the contract permit either party to settle it net in cash or another financial instrument or by exchanging financial instruments;
- (b) When the ability to settle net in cash or another financial instrument, or by exchanging financial instruments, is not explicit in the terms of the contract, but the entity has a practice of settling similar contracts net in cash or another financial instrument or by exchanging financial instruments (whether with the counterparty, by entering into offsetting contracts or by selling the contract before its exercise or lapse);
- (c) When, for similar contracts, the entity has a practice of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin; and
- (d) When the non-financial item that is the subject of the contract is readily convertible to cash.

A contract to which (b) or (c) applies is not entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirements and, accordingly, is within the scope of this Standard. Other contracts to which paragraph 4 applies are evaluated to determine whether they were entered into and continue to be held for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale, or usage requirements and, accordingly, whether they are within the scope of this Standard.

- 6. A written option to buy or sell a non-financial item that can be settled net in cash or another financial instrument, or by exchanging financial instruments, in accordance with paragraph 5(a) or (d) is within the scope of this Standard. Such a contract cannot be entered into for the purpose of the receipt or delivery of the non-financial item in accordance with the entity's expected purchase, sale or usage requirements.
- 7. **This Standard applies to all public sector entities other than Government Business Enterprises.**
- 8. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

Definitions

- 9. The terms defined in IPSAS 28 are used in this Standard with the meanings specified in paragraph 9 of IPSAS 28. IPSAS 28 defines the following terms:
 - Financial instrument;

- Financial asset;
- Financial liability;
- Equity instrument;

and provides guidance on applying those definitions.

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

Definition of a derivative

A **derivative** is a financial instrument or other contract within the scope of this Standard (see paragraphs 2–6) with all three of the following characteristics:

- (a) Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the “underlying”);
- (b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and
- (c) It is settled at a future date.

Definitions of four categories of financial instruments

A **financial asset or financial liability at fair value through surplus or deficit** is a financial asset or financial liability that meets either of the following conditions.

- (a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if:
 - (i) It is acquired or incurred principally for the purpose of selling or repurchasing it in the near term;
 - (ii) On initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or
 - (iii) It is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument).

- (b) Upon initial recognition it is designated by the entity as at fair value through surplus or deficit. An entity may use this designation only when permitted by paragraph 13 or when doing so results in more relevant information, because either:
- (i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as “an accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases; or
 - (ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or investment strategy, and information about the group is provided internally on that basis to the entity’s key management personnel (as defined in IPSAS 20, *Related Party Disclosures*), for example the entity’s governing body and chief executive officer.

In IPSAS 30, paragraphs 11–13 and AG4 require the entity to provide disclosures about financial assets and financial liabilities it has designated as at fair value through surplus or deficit, including how it has satisfied these conditions. For instruments qualifying in accordance with (ii) above, that disclosure includes a narrative description of how designation as at fair value through surplus or deficit is consistent with the entity’s documented risk management or investment strategy.

Investments in equity instruments that do not have a quoted market price in an active market, and whose fair value cannot be reliably measured (see paragraph 48(c) and Appendix A paragraphs AG113 and AG114), shall not be designated as at fair value through surplus or deficit.

It should be noted that paragraphs 50, 51, 52, and Appendix A paragraphs AG101–AG115, which set out requirements for determining a reliable measure of the fair value of a financial asset or financial liability, apply equally to all items that are measured at fair value, whether by designation or otherwise, or whose fair value is disclosed.

Held-to-maturity investments are non-derivative financial assets with fixed or determinable payments and fixed maturity that an entity has the positive intention and ability to hold to maturity (see Appendix A paragraphs AG29–AG38) other than:

- (a) Those that the entity upon initial recognition designates as at fair value through surplus or deficit;
- (b) Those that the entity designates as available for sale; and

(c) Those that meet the definition of loans and receivables.

An entity shall not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that:

- (a) Are so close to maturity or the financial asset's call date (e.g., less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value;
- (b) Occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or
- (c) Are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity.

Loans and receivables are non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than:

- (a) Those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through surplus or deficit;
- (b) Those that the entity upon initial recognition designates as available for sale; or
- (c) Those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.

An interest acquired in a pool of assets that are not loans or receivables (e.g., an interest in a mutual fund or a similar fund) is not a loan or receivable.

Available-for-sale financial assets are those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through surplus or deficit.

Definition of a financial guarantee contract

A **financial guarantee contract** is a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs

because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.

Definitions relating to recognition and measurement

The amortized cost of a financial asset or financial liability is the amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.

The effective interest method is a method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest revenue or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (e.g., prepayment, call and similar options) but shall not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see IPSAS 9, *Revenue from Exchange Transactions*), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).

Derecognition is the removal of a previously recognized financial asset or financial liability from an entity's statement of financial position.

A regular way purchase or sale is a purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.

Transaction costs are incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see Appendix A paragraph AG26). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.

Definitions relating to hedge accounting

A **firm commitment** is a binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.

A **forecast transaction** is an uncommitted but anticipated future transaction.

A **hedging instrument** is a designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item (paragraphs 81–86 and Appendix A paragraphs AG127–AG130 elaborate on the definition of a hedging instrument).

A **hedged item** is an asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value or future cash flows and (b) is designated as being hedged (paragraphs 87–94 and Appendix A paragraphs AG131–AG141 elaborate on the definition of hedged items).

Hedge effectiveness is the degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument (see Appendix A paragraphs AG145–AG156).

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

Embedded Derivatives

11. An embedded derivative is a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative. An embedded derivative causes some or all of the cash flows that otherwise would be required by the contract to be modified according to a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract. A derivative that is attached to a financial instrument but is contractually transferable independently of that instrument, or has a different counterparty from that instrument, is not an embedded derivative, but a separate financial instrument.
12. **An embedded derivative shall be separated from the host contract and accounted for as a derivative under this Standard if, and only if:**

- (a) **The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract (see Appendix A paragraphs AG43 and AG46);**
- (b) **A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and**
- (c) **The hybrid (combined) instrument is not measured at fair value with changes in fair value recognized in surplus or deficit (i.e., a derivative that is embedded in a financial asset or financial liability at fair value through surplus or deficit is not separated).**

If an embedded derivative is separated, the host contract shall be accounted for under this Standard if it is a financial instrument, and in accordance with other appropriate Standards if it is not a financial instrument. This Standard does not address whether an embedded derivative shall be presented separately in the statement of financial position.

13. **Notwithstanding paragraph 12, if a contract contains one or more embedded derivatives, an entity may designate the entire hybrid (combined) contract as a financial asset or financial liability at fair value through surplus or deficit unless:**
 - (a) **The embedded derivative(s) does not significantly modify the cash flows that otherwise would be required by the contract; or**
 - (b) **It is clear with little or no analysis when a similar hybrid (combined) instrument is first considered that separation of the embedded derivative(s) is prohibited, such as a prepayment option embedded in a loan that permits the holder to prepay the loan for approximately its amortized cost.**
14. **If an entity is required by this Standard to separate an embedded derivative from its host contract, but is unable to measure the embedded derivative separately either at acquisition or at the end of a subsequent financial reporting period, it shall designate the entire hybrid (combined) contract as at fair value through surplus or deficit. Similarly, if an entity is unable to measure separately the embedded derivative that would have to be separated on reclassification of a hybrid (combined) contract out of fair value through surplus or deficit category, that reclassification is prohibited. In such circumstances the hybrid (combined) contract remains classified as at fair value through surplus or deficit in its entirety.**
15. **If an entity is unable to determine reliably the fair value of an embedded derivative on the basis of its terms and conditions (e.g., because the embedded derivative is based on an unquoted equity instrument), the fair value of the embedded derivative is the difference between the fair value of the hybrid**

(combined) instrument and the fair value of the host contract, if those can be determined under this Standard. If the entity is unable to determine the fair value of the embedded derivative using this method, paragraph 14 applies and the hybrid (combined) instrument is designated as at fair value through surplus or deficit.

Recognition and Derecognition

Initial Recognition

16. **An entity shall recognize a financial asset or a financial liability in its statement of financial position when, and only when, the entity becomes a party to the contractual provisions of the instrument. (See paragraph 40 with respect to regular way purchases of financial assets).**

Derecognition of a Financial Asset

17. In consolidated financial statements, paragraphs 18–25 and Appendix A paragraphs AG49–AG67 are applied at a consolidated level. Hence, an entity first consolidates all controlled entities in accordance with IPSAS 6 and the relevant international or national accounting standard or interpretation dealing with the consolidation of special purpose entities, and then applies paragraphs 18–25 and Appendix A paragraphs AG49–AG67 to the resulting economic entity.
18. **Before evaluating whether, and to what extent, derecognition is appropriate under paragraphs 19–25, an entity determines whether those paragraphs should be applied to a part of a financial asset (or a part of a group of similar financial assets) or a financial asset (or a group of similar financial assets) in its entirety, as follows.**
 - (a) **Paragraphs 19–25 are applied to a part of a financial asset (or a part of a group of similar financial assets) if, and only if, the part being considered for derecognition meets one of the following three conditions.**
 - (i) **The part comprises only specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an interest rate strip whereby the counterparty obtains the right to the interest cash flows, but not the principal cash flows from a debt instrument, paragraphs 19–25 are applied to the interest cash flows.**
 - (ii) **The part comprises only a fully proportionate (pro rata) share of the cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 percent share of all cash flows of a debt**

instrument, paragraphs 19–25 are applied to 90 percent of those cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the cash flows provided that the transferring entity has a fully proportionate share.

- (iii) The part comprises only a fully proportionate (pro rata) share of specifically identified cash flows from a financial asset (or a group of similar financial assets). For example, when an entity enters into an arrangement whereby the counterparty obtains the rights to a 90 percent share of interest cash flows from a financial asset, paragraphs 19–25 are applied to 90 percent of those interest cash flows. If there is more than one counterparty, each counterparty is not required to have a proportionate share of the specifically identified cash flows provided that the transferring entity has a fully proportionate share.
- (b) In all other cases, paragraphs 19–25 are applied to the financial asset in its entirety (or to the group of similar financial assets in their entirety). For example, when an entity transfers (i) the rights to the first or the last 90 percent of cash collections from a financial asset (or a group of financial assets), or (ii) the rights to 90 percent of the cash flows from a group of receivables, but provides a guarantee to compensate the buyer for any credit losses up to 8 percent of the principal amount of the receivables, paragraphs 19–25 are applied to the financial asset (or a group of similar financial assets) in its entirety.

In paragraphs 19–28, the term “financial asset” refers to either a part of a financial asset (or a part of a group of similar financial assets) as identified in (a) above or, otherwise, a financial asset (or a group of similar financial assets) in its entirety.

- 19. An entity shall derecognize a financial asset when, and only when:
 - (a) The contractual rights to the cash flows from the financial asset expire or are waived; or
 - (b) It transfers the financial asset as set out in paragraphs 20 and 21 and the transfer qualifies for derecognition in accordance with paragraph 22.

(See paragraph 40 for regular way sales of financial assets).
- 20. An entity transfers a financial asset if, and only if, it either:
 - (a) Transfers the contractual rights to receive the cash flows of the financial asset; or

- (b) **Retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients in an arrangement that meets the conditions in paragraph 21.**
21. **When an entity retains the contractual rights to receive the cash flows of a financial asset (the “original asset”), but assumes a contractual obligation to pay those cash flows to one or more entities (the “eventual recipients”), the entity treats the transaction as a transfer of a financial asset if, and only if, all of the following three conditions are met:**
- (a) **The entity has no obligation to pay amounts to the eventual recipients unless it collects equivalent amounts from the original asset. Short-term advances by the entity with the right of full recovery of the amount lent plus accrued interest at market rates do not violate this condition.**
 - (b) **The entity is prohibited by the terms of the transfer contract from selling or pledging the original asset other than as security to the eventual recipients for the obligation to pay them cash flows.**
 - (c) **The entity has an obligation to remit any cash flows it collects on behalf of the eventual recipients without material delay. In addition, the entity is not entitled to reinvest such cash flows, except for investments in cash or cash equivalents (as defined in IPSAS 2, *Cash Flow Statements*) during the short settlement period from the collection date to the date of required remittance to the eventual recipients, and interest earned on such investments is passed to the eventual recipients.**
22. **When an entity transfers a financial asset (see paragraph 20), it shall evaluate the extent to which it retains the risks and rewards of ownership of the financial asset. In this case:**
- (a) **If the entity transfers substantially all the risks and rewards of ownership of the financial asset, the entity shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.**
 - (b) **If the entity retains substantially all the risks and rewards of ownership of the financial asset, the entity shall continue to recognize the financial asset.**
 - (c) **If the entity neither transfers nor retains substantially all the risks and rewards of ownership of the financial asset, the entity shall determine whether it has retained control of the financial asset. In this case:**

- (i) **If the entity has not retained control, it shall derecognize the financial asset and recognize separately as assets or liabilities any rights and obligations created or retained in the transfer.**
 - (ii) **If the entity has retained control, it shall continue to recognize the financial asset to the extent of its continuing involvement in the financial asset (see paragraph 32).**
- 23. The transfer of risks and rewards (see paragraph 22) is evaluated by comparing the entity's exposure, before and after the transfer, with the variability in the amounts and timing of the net cash flows of the transferred asset. An entity has retained substantially all the risks and rewards of ownership of a financial asset if its exposure to the variability in the present value of the future net cash flows from the financial asset does not change significantly as a result of the transfer (e.g., because the entity has sold a financial asset subject to an agreement to buy it back at a fixed price or the sale price plus a lender's return). An entity has transferred substantially all the risks and rewards of ownership of a financial asset if its exposure to such variability is no longer significant in relation to the total variability in the present value of the future net cash flows associated with the financial asset (e.g., because the entity has sold a financial asset subject only to an option to buy it back at its fair value at the time of repurchase or has transferred a fully proportionate share of the cash flows from a larger financial asset in an arrangement, such as a loan sub-participation, that meets the conditions in paragraph 21).
- 24. Often it will be obvious whether the entity has transferred or retained substantially all risks and rewards of ownership and there will be no need to perform any computations. In other cases, it will be necessary to compute and compare the entity's exposure to the variability in the present value of the future net cash flows before and after the transfer. The computation and comparison is made using as the discount rate an appropriate current market interest rate. All reasonably possible variability in net cash flows is considered, with greater weight being given to those outcomes that are more likely to occur.
- 25. Whether the entity has retained control (see paragraph 22(c)) of the transferred asset depends on the transferee's ability to sell the asset. If the transferee has the practical ability to sell the asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without needing to impose additional restrictions on the transfer, the entity has not retained control. In all other cases, the entity has retained control.

Transfers that Qualify for Derecognition (see paragraph 22(a) and (c)(i))

26. **If an entity transfers a financial asset in a transfer that qualifies for derecognition in its entirety and retains the right to service the financial asset for a fee, it shall recognize either a servicing asset or a servicing liability for that servicing contract. If the fee to be received is not expected to compensate the entity adequately for performing the servicing, a servicing liability for the servicing obligation shall be recognized at its fair value. If the fee to be received is expected to be more than adequate compensation for the servicing, a servicing asset shall be recognized for the servicing right at an amount determined on the basis of an allocation of the carrying amount of the larger financial asset in accordance with paragraph 29.**
27. **If, as a result of a transfer, a financial asset is derecognized in its entirety but the transfer results in the entity obtaining a new financial asset or assuming a new financial liability, or a servicing liability, the entity shall recognize the new financial asset, financial liability or servicing liability at fair value.**
28. **On derecognition of a financial asset in its entirety, the difference between:**
 - (a) **The carrying amount; and**
 - (b) **The sum of (i) the consideration received (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss that had been recognized directly in net assets/equity (see paragraph 64(b));****shall be recognized in surplus or deficit.**
29. **If the transferred asset is part of a larger financial asset (e.g., when an entity transfers interest cash flows that are part of a debt instrument, see paragraph 18(a)) and the part transferred qualifies for derecognition in its entirety, the previous carrying amount of the larger financial asset shall be allocated between the part that continues to be recognized and the part that is derecognized, based on the relative fair values of those parts on the date of the transfer. For this purpose, a retained servicing asset shall be treated as a part that continues to be recognized. The difference between:**
 - (a) **The carrying amount allocated to the part derecognized; and**
 - (b) **The sum of (i) the consideration received for the part derecognized (including any new asset obtained less any new liability assumed) and (ii) any cumulative gain or loss allocated to it that had been recognized directly in net assets/equity (see paragraph 64(b));**

shall be recognized in surplus or deficit. A cumulative gain or loss that had been recognized in net assets/equity is allocated between the part that continues to be recognized and the part that is derecognized, based on the relative fair values of those parts.

30. When an entity allocates the previous carrying amount of a larger financial asset between the part that continues to be recognized and the part that is derecognized, the fair value of the part that continues to be recognized needs to be determined. When the entity has a history of selling parts similar to the part that continues to be recognized or other market transactions exist for such parts, recent prices of actual transactions provide the best estimate of its fair value. When there are no price quotes or recent market transactions to support the fair value of the part that continues to be recognized in an exchange transaction, the best estimate of the fair value is the difference between the fair value of the larger financial asset as a whole and the consideration received from the transferee for the part that is derecognized.

Transfers that do not Qualify for Derecognition (see paragraph 22(b))

31. **If a transfer does not result in derecognition because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the entity shall continue to recognize the transferred asset in its entirety and shall recognize a financial liability for the consideration received. In subsequent periods, the entity shall recognize any revenue on the transferred asset and any expense incurred on the financial liability.**

Continuing Involvement in Transferred Assets (see paragraph 22(c)(ii))

32. **If an entity neither transfers nor retains substantially all the risks and rewards of ownership of a transferred asset, and retains control of the transferred asset, the entity continues to recognize the transferred asset to the extent of its continuing involvement. The extent of the entity's continuing involvement in the transferred asset is the extent to which it is exposed to changes in the value of the transferred asset. For example:**
- (a) **When the entity's continuing involvement takes the form of guaranteeing the transferred asset, the extent of the entity's continuing involvement is the lower of (i) the amount of the asset and (ii) the maximum amount of the consideration received that the entity could be required to repay ("the guarantee amount").**
 - (b) **When the entity's continuing involvement takes the form of a written or purchased option (or both) on the transferred asset, the extent of the entity's continuing involvement is the amount of the transferred asset that the entity may repurchase. However, in case of a written put option on an asset that is measured at fair value, the extent of the entity's continuing involvement is limited to the**

lower of the fair value of the transferred asset and the option exercise price (see paragraph AG63).

- (c) When the entity's continuing involvement takes the form of a cash-settled option or similar provision on the transferred asset, the extent of the entity's continuing involvement is measured in the same way as that which results from non-cash settled options as set out in (b) above.
33. When an entity continues to recognize an asset to the extent of its continuing involvement, the entity also recognizes an associated liability. Despite the other measurement requirements in this Standard, the transferred asset and the associated liability are measured on a basis that reflects the rights and obligations that the entity has retained. The associated liability is measured in such a way that the net carrying amount of the transferred asset and the associated liability is:
- (a) The amortized cost of the rights and obligations retained by the entity, if the transferred asset is measured at amortized cost; or
 - (b) Equal to the fair value of the rights and obligations retained by the entity when measured on a stand-alone basis, if the transferred asset is measured at fair value.
34. The entity shall continue to recognize any revenue arising on the transferred asset to the extent of its continuing involvement and shall recognize any expense incurred on the associated liability.
35. For the purpose of subsequent measurement, recognized changes in the fair value of the transferred asset and the associated liability are accounted for consistently with each other in accordance with paragraph 64, and shall not be offset.
36. If an entity's continuing involvement is in only a part of a financial asset (e.g., when an entity retains an option to repurchase part of a transferred asset, or retains a residual interest that does not result in the retention of substantially all the risks and rewards of ownership and the entity retains control), the entity allocates the previous carrying amount of the financial asset between the part it continues to recognize under continuing involvement, and the part it no longer recognizes on the basis of the relative fair values of those parts on the date of the transfer. For this purpose, the requirements of paragraph 30 apply. The difference between:
- (a) The carrying amount allocated to the part that is no longer recognized; and
 - (b) The sum of (i) the consideration received for the part no longer recognized and (ii) any cumulative gain or loss allocated to it that

had been recognized directly in net assets/equity (see paragraph 64(b));

shall be recognized in surplus or deficit. A cumulative gain or loss that had been recognized in net assets/equity is allocated between the part that continues to be recognized and the part that is no longer recognized on the basis of the relative fair values of those parts.

37. If the transferred asset is measured at amortized cost, the option in this Standard to designate a financial liability as at fair value through surplus or deficit is not applicable to the associated liability.

All Transfers

38. **If a transferred asset continues to be recognized, the asset and the associated liability shall not be offset. Similarly, the entity shall not offset any revenue arising from the transferred asset with any expense incurred on the associated liability (see IPSAS 28 paragraph 47).**
39. **If a transferor provides non-cash collateral (such as debt or equity instruments) to the transferee, the accounting for the collateral by the transferor and the transferee depends on whether the transferee has the right to sell or repledge the collateral and on whether the transferor has defaulted. The transferor and transferee shall account for the collateral as follows:**
- (a) **If the transferee has the right by contract or custom to sell or repledge the collateral, then the transferor shall reclassify that asset in its statement of financial position (e.g., as a loaned asset, pledged equity instruments or repurchase receivable) separately from other assets.**
 - (b) **If the transferee sells collateral pledged to it, it shall recognize the proceeds from the sale and a liability measured at fair value for its obligation to return the collateral.**
 - (c) **If the transferor defaults under the terms of the contract and is no longer entitled to redeem the collateral, it shall derecognize the collateral, and the transferee shall recognize the collateral as its asset initially measured at fair value or, if it has already sold the collateral, derecognize its obligation to return the collateral.**
 - (d) **Except as provided in (c), the transferor shall continue to carry the collateral as its asset, and the transferee shall not recognize the collateral as an asset.**

Regular Way Purchase or Sale of a Financial Asset

40. **A regular way purchase or sale of financial assets shall be recognized and derecognized, as applicable, using trade date accounting or settlement date accounting (see Appendix A paragraphs AG68–AG71).**

Derecognition of a Financial Liability

41. **An entity shall remove a financial liability (or a part of a financial liability) from its statement of financial position when, and only when, it is extinguished – i.e., when the obligation specified in the contract is discharged, waived, cancelled or expires.**
42. **An exchange between an existing borrower and lender of debt instruments with substantially different terms shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, a substantial modification of the terms of an existing financial liability or a part of it (whether or not attributable to the financial difficulty of the debtor) shall be accounted for as an extinguishment of the original financial liability and the recognition of a new financial liability.**
43. **The difference between the carrying amount of a financial liability (or part of a financial liability) extinguished or transferred to another party and the consideration paid, including any non-cash assets transferred or liabilities assumed, shall be recognized in surplus or deficit. Where an obligation is waived by the lender or assumed by a third party as part of a non-exchange transaction, an entity applies IPSAS 23.**
44. **If an entity repurchases a part of a financial liability, the entity shall allocate the previous carrying amount of the financial liability between the part that continues to be recognized and the part that is derecognized based on the relative fair values of those parts on the date of the repurchase. The difference between (a) the carrying amount allocated to the part derecognized and (b) the consideration paid, including any non-cash assets transferred or liabilities assumed, for the part derecognized shall be recognized in surplus or deficit.**

Measurement**Initial Measurement of Financial Assets and Financial Liabilities**

45. **When a financial asset or financial liability is recognized initially, an entity shall measure it at its fair value plus, in the case of a financial asset or financial liability not at fair value through surplus or deficit, transaction costs that are directly attributable to the acquisition or issue of the financial asset or financial liability.**
46. **When an entity uses settlement date accounting for an asset that is subsequently measured at cost or amortized cost, the asset is recognized**

initially at its fair value on the trade date (see Appendix A paragraphs AG68–AG71).

Subsequent Measurement of Financial Assets

47. For the purpose of measuring a financial asset after initial recognition, this Standard classifies financial assets into the following four categories defined in paragraph 10:

- (a) Financial assets at fair value through surplus or deficit;
- (b) Held-to-maturity investments;
- (c) Loans and receivables; and
- (d) Available-for-sale financial assets.

These categories apply to measurement and surplus or deficit recognition under this Standard. The entity may use other descriptors for these categories or other categorizations when presenting information in the financial statements. The entity shall disclose in the notes the information required by IPSAS 30.

48. **After initial recognition, an entity shall measure financial assets, including derivatives that are assets, at their fair values, without any deduction for transaction costs it may incur on sale or other disposal, except for the following financial assets:**

- (a) **Loans and receivables as defined in paragraph 10, which shall be measured at amortized cost using the effective interest method;**
- (b) **Held-to-maturity investments as defined in paragraph 10, which shall be measured at amortized cost using the effective interest method; and**
- (c) **Investments in equity instruments that do not have a quoted market price in an active market and whose fair value cannot be reliably measured and derivatives that are linked to and must be settled by delivery of such unquoted equity instruments, which shall be measured at cost (see Appendix A paragraphs AG113 and AG114).**

Financial assets that are designated as hedged items are subject to measurement under the hedge accounting requirements in paragraphs 99–113. All financial assets except those measured at fair value through surplus or deficit are subject to review for impairment in accordance with paragraphs 67–79 and Appendix A paragraphs AG117–AG126.

Subsequent Measurement of Financial Liabilities

49. **After initial recognition, an entity shall measure all financial liabilities at amortized cost using the effective interest method, except for:**
- (a) **Financial liabilities at fair value through surplus or deficit. Such liabilities, including derivatives that are liabilities, shall be measured at fair value except for a derivative liability that is linked to and must be settled by delivery of an unquoted equity instrument whose fair value cannot be reliably measured, which shall be measured at cost.**
 - (b) **Financial liabilities that arise when a transfer of a financial asset does not qualify for derecognition or when the continuing involvement approach applies. Paragraphs 31 and 33 apply to the measurement of such financial liabilities.**
 - (c) **Financial guarantee contracts as defined in paragraph 10. After initial recognition, an issuer of such a contract shall (unless paragraph 49(a) or (b) applies) measure it at the higher of:**
 - (i) **The amount determined in accordance with IPSAS 19; and**
 - (ii) **The amount initially recognized (see paragraph 45) less, when appropriate, cumulative amortization recognized in accordance with IPSAS 9.**
 - (d) **Commitments to provide a loan at a below-market interest rate. After initial recognition, an issuer of such a commitment shall (unless paragraph 49(a) applies) measure it at the higher of:**
 - (i) **The amount determined in accordance with IPSAS 19; and**
 - (ii) **The amount initially recognized (see paragraph 45) less, when appropriate, cumulative amortization recognized in accordance with IPSAS 9.**

Financial liabilities that are designated as hedged items are subject to the hedge accounting requirements in paragraphs 99–113.

Fair Value Measurement Considerations

50. **In determining the fair value of a financial asset or a financial liability for the purpose of applying this Standard, IPSAS 28 or IPSAS 30, an entity shall apply paragraphs AG101–AG115 of Appendix A.**
51. **The best evidence of fair value is quoted prices in an active market. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating**

considerations. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique. The chosen valuation technique makes maximum use of market inputs and relies as little as possible on entity-specific inputs. It incorporates all factors that market participants would consider in setting a price and is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data.

52. The fair value of a financial liability with a demand feature (e.g., a demand deposit) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid.

Reclassifications

53. **An entity:**

- (a) **Shall not reclassify a derivative out of the fair value through surplus or deficit category while it is held or issued;**
- (b) **Shall not reclassify any financial instrument out of the fair value through surplus or deficit category if upon initial recognition it was designated by the entity as at fair value through surplus or deficit; and**
- (c) **May, if a financial asset is no longer held for the purpose of selling or repurchasing it in the near term (notwithstanding that the financial asset may have been acquired or incurred principally for the purpose of selling or repurchasing it in the near term), reclassify that financial asset out of the fair value through surplus or deficit category if the requirements in paragraph 55 or 57 are met.**

An entity shall not reclassify any financial instrument into the fair value through surplus or deficit category after initial recognition.

54. The following changes in circumstances are not reclassifications for the purposes of paragraph 53:
- (a) A derivative that was previously a designated and effective hedging instrument in a cash flow hedge or net investment hedge no longer qualifies as such; and

- (b) A derivative becomes a designated and effective hedging instrument in a cash flow hedge or net investment hedge.
55. A financial asset to which paragraph 53(c) applies (except a financial asset of the type described in paragraph 57) may be reclassified out of the fair value through surplus or deficit category only in rare circumstances.
 56. If an entity reclassifies a financial asset out of the fair value through surplus or deficit category in accordance with paragraph 55, the financial asset shall be reclassified at its fair value on the date of reclassification. Any gain or loss already recognized in surplus or deficit shall not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable.
 57. A financial asset to which paragraph 53(c) applies that would have met the definition of loans and receivables (if the financial asset had not been required to be classified as held for trading at initial recognition) may be reclassified out of the fair value through surplus or deficit category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.
 58. A financial asset classified as available for sale that would have met the definition of loans and receivables (if it had not been designated as available for sale) may be reclassified out of the available-for-sale category to the loans and receivables category if the entity has the intention and ability to hold the financial asset for the foreseeable future or until maturity.
 59. If an entity reclassifies a financial asset out of the fair value through surplus or deficit category in accordance with paragraph 57 or out of the available-for-sale category in accordance with paragraph 58, it shall reclassify the financial asset at its fair value on the date of reclassification. For a financial asset reclassified in accordance with paragraph 57, any gain or loss already recognized in surplus or deficit shall not be reversed. The fair value of the financial asset on the date of reclassification becomes its new cost or amortized cost, as applicable. For a financial asset reclassified out of the available-for-sale category in accordance with paragraph 58, any previous gain or loss on that asset that has been recognized directly in net assets/equity in accordance with paragraph 64(b) shall be accounted for in accordance with paragraph 63.
 60. **If, as a result of a change in intention or ability, it is no longer appropriate to classify an investment as held to maturity, it shall be reclassified as available for sale and remeasured at fair value, and the difference between its carrying amount and fair value shall be accounted for in accordance with paragraph 64(b).**
 61. **Whenever sales or reclassification of more than an insignificant amount of held-to-maturity investments do not meet any of the conditions in**

paragraph 10, any remaining held-to-maturity investments shall be reclassified as available for sale. On such reclassification, the difference between their carrying amount and fair value shall be accounted for in accordance with paragraph 64(b).

62. If a reliable measure becomes available for a financial asset or financial liability for which such a measure was previously not available, and the asset or liability is required to be measured at fair value if a reliable measure is available (see paragraphs 48(c) and 49), the asset or liability shall be remeasured at fair value, and the difference between its carrying amount and fair value shall be accounted for in accordance with paragraph 64.
63. If, as a result of a change in intention or ability or in the rare circumstance that a reliable measure of fair value is no longer available (see paragraphs 48(c) and 49) or because the “two preceding financial years” referred to in paragraph 10 have passed, it becomes appropriate to carry a financial asset or financial liability at cost or amortized cost rather than at fair value, the fair value carrying amount of the financial asset or the financial liability on that date becomes its new cost or amortized cost, as applicable. Any previous gain or loss on that asset that has been recognized directly in net assets/equity in accordance with paragraph 64(b) shall be accounted for as follows:
 - (a) In the case of a financial asset with a fixed maturity, the gain or loss shall be amortized to surplus or deficit over the remaining life of the held-to-maturity investment using the effective interest method. Any difference between the new amortized cost and maturity amount shall also be amortized over the remaining life of the financial asset using the effective interest method, similar to the amortization of a premium and a discount. If the financial asset is subsequently impaired, any gain or loss that has been recognized directly in net assets/equity is recognized in surplus or deficit in accordance with paragraph 76.
 - (b) In the case of a financial asset that does not have a fixed maturity, the gain or loss shall remain in net assets/equity until the financial asset is sold or otherwise disposed of, when it shall be recognized in surplus or deficit. If the financial asset is subsequently impaired any previous gain or loss that has been recognized directly in net assets/equity is recognized in surplus or deficit in accordance with paragraph 76.

Gains and Losses

64. A gain or loss arising from a change in the fair value of a financial asset or financial liability that is not part of a hedging relationship (see paragraphs 99–113), shall be recognized, as follows.
- (a) A gain or loss on a financial asset or financial liability classified as at fair value through surplus or deficit shall be recognized in surplus or deficit.
 - (b) A gain or loss on an available-for-sale financial asset shall be recognized directly in net assets/equity through the statement of changes in net assets/equity (see IPSAS 1, except for impairment losses (see paragraphs 76–79) and foreign exchange gains and losses (see Appendix A paragraph AG116), until the financial asset is derecognized, at which time the cumulative gain or loss previously recognized in net assets/equity shall be recognized in surplus or deficit. However, interest calculated using the effective interest method (see paragraph 10) is recognized in surplus or deficit (see IPSAS 9). Dividends or similar distributions on an available-for-sale equity instrument are recognized in surplus or deficit when the entity's right to receive payment is established (see IPSAS 9).
65. For financial assets and financial liabilities carried at amortized cost (see paragraphs 48 and 49), a gain or loss is recognized in surplus or deficit when the financial asset or financial liability is derecognized or impaired, and through the amortization process. However, for financial assets or financial liabilities that are hedged items (see paragraphs 87–94 and Appendix A paragraphs AG131–AG141) the accounting for the gain or loss shall follow paragraphs 99–113.
66. If an entity recognizes financial assets using settlement date accounting (see paragraph 40 and Appendix A paragraphs AG68 and AG71), any change in the fair value of the asset to be received during the period between the trade date and the settlement date is not recognized for assets carried at cost or amortized cost (other than impairment losses). For assets carried at fair value, however, the change in fair value shall be recognized in surplus or deficit or in net assets/equity, as appropriate under paragraph 64.

Impairment and Uncollectibility of Financial Assets

67. An entity shall assess at the end of each reporting period whether there is any objective evidence that a financial asset or group of financial assets is impaired. If any such evidence exists, the entity shall apply paragraph 72 (for financial assets carried at amortized cost), paragraph 75 (for

financial assets carried at cost) or paragraph 76 (for available-for-sale financial assets) to determine the amount of any impairment loss.

68. A financial asset or a group of financial assets is impaired and impairment losses are incurred if, and only if, there is objective evidence of impairment as a result of one or more events that occurred after the initial recognition of the asset (a “loss event”) and that loss event (or events) has an impact on the estimated future cash flows of the financial asset or group of financial assets that can be reliably estimated. It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment. Losses expected as a result of future events, no matter how likely, are not recognized. Objective evidence that a financial asset or group of assets is impaired includes observable data that comes to the attention of the holder of the asset about the following loss events:
- (a) Significant financial difficulty of the issuer or obligor;
 - (b) A breach of contract, such as a default or delinquency in interest or principal payments;
 - (c) The lender, for economic or legal reasons relating to the borrower’s financial difficulty, granting to the borrower a concession that the lender would not otherwise consider;
 - (d) It becoming probable that the borrower will enter bankruptcy or other financial reorganization;
 - (e) The disappearance of an active market for that financial asset because of financial difficulties; or
 - (f) Observable data indicating that there is a measurable decrease in the estimated future cash flows from a group of financial assets since the initial recognition of those assets, although the decrease cannot yet be identified with the individual financial assets in the group, including:
 - (i) Adverse changes in the payment status of borrowers in the group (e.g., an increased number of delayed payments); or
 - (ii) National or local economic conditions that correlate with defaults on the assets in the group (e.g., an increase in the unemployment rate in the geographical area of the borrowers, a decrease in oil prices for loan assets to oil producers, or adverse changes in industry conditions that affect the borrowers in the group).
69. The disappearance of an active market because an entity’s financial instruments are no longer publicly traded is not evidence of impairment. A downgrade of an entity’s credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other

available information. A decline in the fair value of a financial asset below its cost or amortized cost is not necessarily evidence of impairment (e.g., a decline in the fair value of an investment in a debt instrument that results from an increase in the risk-free interest rate).

70. In addition to the types of events in paragraph 68, objective evidence of impairment for an investment in an equity instrument includes information about significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates, and indicates that the cost of the investment in the equity instrument may not be recovered. A significant or prolonged decline in the fair value of an investment in an equity instrument below its cost is also objective evidence of impairment.
71. In some cases the observable data required to estimate the amount of an impairment loss on a financial asset may be limited or no longer fully relevant to current circumstances. For example, this may be the case when a borrower is in financial difficulties and there are few available historical data relating to similar borrowers. In such cases, an entity uses its experienced judgment to estimate the amount of any impairment loss. Similarly an entity uses its experienced judgment to adjust observable data for a group of financial assets to reflect current circumstances (see paragraph AG122). The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability.

Financial Assets Carried at Amortized Cost

72. **If there is objective evidence that an impairment loss on loans and receivables or held-to-maturity investments carried at amortized cost has been incurred, the amount of the loss is measured as the difference between the asset's carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset's original effective interest rate (i.e., the effective interest rate computed at initial recognition). The carrying amount of the asset shall be reduced either directly or through use of an allowance account. The amount of the loss shall be recognized in surplus or deficit.**
73. An entity first assesses whether objective evidence of impairment exists individually for financial assets that are individually significant, and individually or collectively for financial assets that are not individually significant (see paragraph 68). If an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics and collectively assesses them for impairment. Assets that are individually assessed for impairment and for

which an impairment loss is or continues to be recognized are not included in a collective assessment of impairment.

74. **If, in a subsequent period, the amount of the impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognized (such as an improvement in the debtor's credit rating), the previously recognized impairment loss shall be reversed either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset that exceeds what the amortized cost would have been had the impairment not been recognized at the date the impairment is reversed. The amount of the reversal shall be recognized in surplus or deficit.**

Financial Assets Carried at Cost

75. **If there is objective evidence that an impairment loss has been incurred on an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured, or on a derivative asset that is linked to and must be settled by delivery of such an unquoted equity instrument, the amount of the impairment loss is measured as the difference between the carrying amount of the financial asset and the present value of estimated future cash flows discounted at the current market rate of return for a similar financial asset (see paragraph 48(c) and Appendix A paragraphs AG113 and AG114). Such impairment losses shall not be reversed.**

Available-For-Sale Financial Assets

76. **When a decline in the fair value of an available-for-sale financial asset has been recognized directly in net assets/equity and there is objective evidence that the asset is impaired (see paragraph 68), the cumulative loss that had been recognized directly in net assets/equity shall be removed from net assets/equity and recognized in surplus or deficit even though the financial asset has not been derecognized.**
77. **The amount of the cumulative loss that is removed from net assets/equity and recognized in surplus or deficit under paragraph 76 shall be the difference between the acquisition cost (net of any principal repayment and amortization) and current fair value, less any impairment loss on that financial asset previously recognized in surplus or deficit.**
78. **Impairment losses recognized in surplus or deficit for an investment in an equity instrument classified as available for sale shall not be reversed through surplus or deficit.**
79. **If, in a subsequent period, the fair value of a debt instrument classified as available for sale increases and the increase can be objectively related to an event occurring after the impairment loss was recognized in surplus or**

deficit, the impairment loss shall be reversed, with the amount of the reversal recognized in surplus or deficit.

Hedging

80. **If there is a designated hedging relationship between a hedging instrument and a hedged item as described in paragraphs 95–98 and Appendix A paragraphs AG142–AG144, accounting for the gain or loss on the hedging instrument and the hedged item shall follow paragraphs 99–113.**

Hedging Instruments

Qualifying Instruments

81. This Standard does not restrict the circumstances in which a derivative may be designated as a hedging instrument provided the conditions in paragraph 98 are met, except for some written options (see Appendix A paragraph AG127). However, a non-derivative financial asset or non-derivative financial liability may be designated as a hedging instrument only for a hedge of a foreign currency risk.
82. For hedge accounting purposes, only instruments that involve a party external to the reporting entity (i.e., external to the economic entity or individual entity that is being reported on) can be designated as hedging instruments. Although individual entities within an economic entity or divisions within an entity may enter into hedging transactions with other entities within the economic entity or divisions within the entity, any such transactions within the economic entity are eliminated on consolidation. Therefore, such hedging transactions do not qualify for hedge accounting in the consolidated financial statements of the economic entity. However, they may qualify for hedge accounting in the individual or separate financial statements of individual entities within the economic entity provided that they are external to the individual entity that is being reported on.

Designation of Hedging Instruments

83. There is normally a single fair value measure for a hedging instrument in its entirety, and the factors that cause changes in fair value are co-dependent. Thus, a hedging relationship is designated by an entity for a hedging instrument in its entirety. The only exceptions permitted are:
- (a) Separating the intrinsic value and time value of an option contract and designating as the hedging instrument only the change in intrinsic value of an option and excluding change in its time value; and
 - (b) Separating the interest element and the spot price of a forward contract.

These exceptions are permitted because the intrinsic value of the option and the premium on the forward can generally be measured separately. A dynamic hedging strategy that assesses both the intrinsic value and time value of an option contract can qualify for hedge accounting.

84. A proportion of the entire hedging instrument, such as 50 percent of the notional amount, may be designated as the hedging instrument in a hedging relationship. However, a hedging relationship may not be designated for only a portion of the time period during which a hedging instrument remains outstanding.
85. A single hedging instrument may be designated as a hedge of more than one type of risk provided that (a) the risks hedged can be identified clearly; (b) the effectiveness of the hedge can be demonstrated; and (c) it is possible to ensure that there is specific designation of the hedging instrument and different risk positions.
86. Two or more derivatives, or proportions of them (or, in the case of a hedge of currency risk, two or more non-derivatives or proportions of them, or a combination of derivatives and non-derivatives or proportions of them), may be viewed in combination and jointly designated as the hedging instrument, including when the risk(s) arising from some derivatives offset(s) those arising from others. However, an interest rate collar or other derivative instrument that combines a written option and a purchased option does not qualify as a hedging instrument if it is, in effect, a net written option (for which a net premium is received). Similarly, two or more instruments (or proportions of them) may be designated as the hedging instrument only if none of them is a written option or a net written option.

Hedged Items

Qualifying Items

87. A hedged item can be a recognized asset or liability, an unrecognized firm commitment, a highly probable forecast transaction or a net investment in a foreign operation. The hedged item can be (a) a single asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation, (b) a group of assets, liabilities, firm commitments, highly probable forecast transactions or net investments in foreign operations with similar risk characteristics, or (c) in a portfolio hedge of interest rate risk only, a portion of the portfolio of financial assets or financial liabilities that share the risk being hedged.
88. Unlike loans and receivables, a held-to-maturity investment cannot be a hedged item with respect to interest-rate risk or prepayment risk because designation of an investment as held to maturity requires an intention to hold the investment until maturity without regard to changes in the fair value or cash flows of such an investment attributable to changes in interest rates.

However, a held-to-maturity investment can be a hedged item with respect to risks from changes in foreign currency exchange rates and credit risk.

89. For hedge accounting purposes, only assets, liabilities, firm commitments or highly probable forecast transactions that involve a party external to the entity can be designated as hedged items. It follows that hedge accounting can be applied to transactions between entities in the same economic entity only in the individual or separate financial statements of those entities and not in the consolidated financial statements of the economic entity. As an exception, the foreign currency risk of monetary item within an economic entity (e.g., a payable/receivable between two controlled entities) may qualify as a hedged item in the consolidated financial statements if it results in an exposure to foreign exchange rate gains or losses that are not fully eliminated on consolidation in accordance with IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*. In accordance with IPSAS 4, foreign exchange rate gains and losses on monetary items within an economic entity are not fully eliminated on consolidation when the monetary item is transacted between two entities within the economic entity that have different functional currencies. In addition, the foreign currency risk of a highly probable forecast transaction within the economic entity may qualify as a hedged item in consolidated financial statements provided that the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated surplus or deficit.

Designation of Financial Items as Hedged Items

90. If the hedged item is a financial asset or financial liability, it may be a hedged item with respect to the risks associated with only a portion of its cash flows or fair value (such as one or more selected contractual cash flows or portions of them or a percentage of the fair value) provided that effectiveness can be measured. For example, an identifiable and separately measurable portion of the interest rate exposure of an interest-bearing asset or interest-bearing liability may be designated as the hedged risk (such as a risk-free interest rate or benchmark interest rate component of the total interest rate exposure of a hedged financial instrument).
91. In a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only in such a hedge), the portion hedged may be designated in terms of an amount of a currency (e.g., an amount of dollars, euro, pounds or rand) rather than as individual assets (or liabilities). Although the portfolio may, for risk management purposes, include assets and liabilities, the amount designated is an amount of assets or an amount of liabilities. Designation of a net amount including assets and liabilities is not permitted. The entity may hedge a portion of the interest rate risk associated with this designated amount. For example, in the case of a hedge of a portfolio containing prepayable assets, the entity may hedge the change in fair value

that is attributable to a change in the hedged interest rate on the basis of expected, rather than contractual, repricing dates. When the portion hedged is based on expected repricing dates, the effect that changes in the hedged interest rate have on those expected repricing dates shall be included when determining the change in the fair value of the hedged item. Consequently, if a portfolio that contains prepayable items is hedged with a non-prepayable derivative, ineffectiveness arises if the dates on which items in the hedged portfolio are expected to prepay are revised, or actual prepayment dates differ from those expected.

Designation of Non-Financial Items as Hedged Items

92. **If the hedged item is a non-financial asset or non-financial liability, it shall be designated as a hedged item (a) for foreign currency risks, or (b) in its entirety for all risks, because of the difficulty of isolating and measuring the appropriate portion of the cash flows or fair value changes attributable to specific risks other than foreign currency risks.**

Designation of Groups of Items as Hedged Items

93. Similar assets or similar liabilities shall be aggregated and hedged as a group only if the individual assets or individual liabilities in the group share the risk exposure that is designated as being hedged. Furthermore, the change in fair value attributable to the hedged risk for each individual item in the group shall be expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group of items.
94. Because an entity assesses hedge effectiveness by comparing the change in the fair value or cash flow of a hedging instrument (or group of similar hedging instruments) and a hedged item (or group of similar hedged items), comparing a hedging instrument with an overall net position (e.g., the net of all fixed rate assets and fixed rate liabilities with similar maturities), rather than with a specific hedged item, does not qualify for hedge accounting.

Hedge Accounting

95. Hedge accounting recognizes the offsetting effects on surplus or deficit of changes in the fair values of the hedging instrument and the hedged item.
96. **Hedging relationships are of three types:**
- (a) **Fair value hedge: a hedge of the exposure to changes in fair value of a recognized asset or liability or an unrecognized firm commitment, or an identified portion of such an asset, liability or firm commitment, that is attributable to a particular risk and could affect surplus or deficit.**
 - (b) **Cash flow hedge: a hedge of the exposure to variability in cash flows that (i) is attributable to a particular risk associated with a**

recognized asset or liability (such as all or some future interest payments on variable rate debt) or a highly probable forecast transaction and (ii) could affect surplus or deficit.

- (c) **Hedge of a net investment in a foreign operation as defined in IPSAS 4.**

97. A hedge of the foreign currency risk of a firm commitment may be accounted for as a fair value hedge or as a cash flow hedge.

98. **A hedging relationship qualifies for hedge accounting under paragraphs 99–113 if, and only if, all of the following conditions are met.**

- (a) **At the inception of the hedge there is formal designation and documentation of the hedging relationship and the entity's risk management objective and strategy for undertaking the hedge. That documentation shall include identification of the hedging instrument, the hedged item or transaction, the nature of the risk being hedged and how the entity will assess the hedging instrument's effectiveness in offsetting the exposure to changes in the hedged item's fair value or cash flows attributable to the hedged risk.**
- (b) **The hedge is expected to be highly effective (see Appendix A paragraphs AG145–AG156) in achieving offsetting changes in fair value or cash flows attributable to the hedged risk, consistently with the originally documented risk management strategy for that particular hedging relationship.**
- (c) **For cash flow hedges, a forecast transaction that is the subject of the hedge must be highly probable and must present an exposure to variations in cash flows that could ultimately affect surplus or deficit.**
- (d) **The effectiveness of the hedge can be reliably measured, i.e., the fair value or cash flows of the hedged item that are attributable to the hedged risk and the fair value of the hedging instrument can be reliably measured (see paragraphs 48 and 49 and Appendix A paragraphs AG113 and AG114 for guidance on determining fair value).**
- (e) **The hedge is assessed on an ongoing basis and determined actually to have been highly effective throughout the financial reporting periods for which the hedge was designated.**

Fair Value Hedges

99. **If a fair value hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:**

- (a) **The gain or loss from remeasuring the hedging instrument at fair value (for a derivative hedging instrument) or the foreign currency component of its carrying amount measured in accordance with IPSAS 4 (for a non-derivative hedging instrument) shall be recognized in surplus or deficit; and**
 - (b) **The gain or loss on the hedged item attributable to the hedged risk shall adjust the carrying amount of the hedged item and be recognized in surplus or deficit. This applies if the hedged item is otherwise measured at cost. Recognition of the gain or loss attributable to the hedged risk in surplus or deficit applies if the hedged item is an available-for-sale financial asset.**
100. For a fair value hedge of the interest rate exposure of a portion of a portfolio of financial assets or financial liabilities (and only in such a hedge), the requirement in paragraph 99(b) may be met by presenting the gain or loss attributable to the hedged item either:
- (a) In a single separate line item within assets, for those repricing time periods for which the hedged item is an asset; or
 - (b) In a single separate line item within liabilities, for those repricing time periods for which the hedged item is a liability.
- The separate line items referred to in (a) and (b) above shall be presented next to financial assets or financial liabilities. Amounts included in these line items shall be removed from the statement of financial position when the assets or liabilities to which they relate are derecognized.
101. If only particular risks attributable to a hedged item are hedged, recognized changes in the fair value of the hedged item unrelated to the hedged risk are recognized as set out in paragraph 64.
102. **An entity shall discontinue prospectively the hedge accounting specified in paragraph 99 if:**
- (a) **The hedging instrument expires or is sold, terminated or exercised (for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy);**
 - (b) **The hedge no longer meets the criteria for hedge accounting in paragraph 98; or**
 - (c) **The entity revokes the designation.**
103. **Any adjustment arising from paragraph 99(b) to the carrying amount of a hedged financial instrument for which the effective interest method is used (or, in the case of a portfolio hedge of interest rate risk, to the**

separate line item in the statement of financial position described in paragraph 100) shall be amortized to surplus or deficit. Amortization may begin as soon as an adjustment exists and shall begin no later than when the hedged item ceases to be adjusted for changes in its fair value attributable to the risk being hedged. The adjustment is based on a recalculated effective interest rate at the date amortization begins. However, if, in the case of a fair value hedge of the interest rate exposure of a portfolio of financial assets or financial liabilities (and only in such a hedge), amortizing using a recalculated effective interest rate is not practicable, the adjustment shall be amortized using a straight-line method. The adjustment shall be amortized fully by maturity of the financial instrument or, in the case of a portfolio hedge of interest rate risk, by expiry of the relevant repricing time period.

104. When an unrecognized firm commitment is designated as a hedged item, the subsequent cumulative change in the fair value of the firm commitment attributable to the hedged risk is recognized as an asset or liability with a corresponding gain or loss recognized in surplus or deficit (see paragraph 99(b)). The changes in the fair value of the hedging instrument are also recognized in surplus or deficit.
105. When an entity enters into a firm commitment to acquire an asset or assume a liability that is a hedged item in a fair value hedge, the initial carrying amount of the asset or liability that results from the entity meeting the firm commitment is adjusted to include the cumulative change in the fair value of the firm commitment attributable to the hedged risk that was recognized in the statement of financial position.

Cash Flow Hedges

106. **If a cash flow hedge meets the conditions in paragraph 98 during the period, it shall be accounted for as follows:**
 - (a) **The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) shall be recognized directly in net assets/equity through the statement of changes in net assets/equity; and**
 - (b) **The ineffective portion of the gain or loss on the hedging instrument shall be recognized in surplus or deficit.**
107. More specifically, a cash flow hedge is accounted for as follows:
 - (a) The separate component of net assets/equity associated with the hedged item is adjusted to the lesser of the following (in absolute amounts):
 - (i) The cumulative gain or loss on the hedging instrument from inception of the hedge; and

- (ii) The cumulative change in fair value (present value) of the expected future cash flows on the hedged item from inception of the hedge;
 - (b) Any remaining gain or loss on the hedging instrument or designated component of it (that is not an effective hedge) is recognized in surplus or deficit; and
 - (c) If an entity's documented risk management strategy for a particular hedging relationship excludes from the assessment of hedge effectiveness a specific component of the gain or loss or related cash flows on the hedging instrument (see paragraphs 83, 84, and 98(a)), that excluded component of gain or loss is recognized in accordance with paragraph 64.
108. **If a hedge of a forecast transaction subsequently results in the recognition of a financial asset or a financial liability, the associated gains or losses that were recognized directly in net assets/equity in accordance with paragraph 106 shall be reclassified into surplus or deficit in the same period or periods during which the hedged forecast cash flows affects surplus or deficit (such as in the periods that interest revenue or interest expense is recognized). However, if an entity expects that all or a portion of a loss recognized directly in net assets/equity will not be recovered in one or more future periods, it shall reclassify into surplus or deficit the amount that is not expected to be recovered.**
109. **If a hedge of a forecast transaction subsequently results in the recognition of a non-financial asset or a non-financial liability, or a forecast transaction for a non-financial asset or non-financial liability becomes a firm commitment for which fair value hedge accounting is applied, then the entity shall adopt (a) or (b) below:**
- (a) **It reclassifies the associated gains and losses that were recognized directly in net assets/equity in accordance with paragraph 106 into surplus or deficit in the same period or periods during which the asset acquired or liability assumed affects surplus or deficit (such as in the periods that depreciation or inventories are recognized as an expense). However, if an entity expects that all or a portion of a loss recognized directly in net assets/equity will not be recovered in one or more future periods, it shall reclassify from net assets/equity into surplus or deficit the amount that is not expected to be recovered.**
 - (b) **It removes the associated gains and losses that were recognized directly in net assets/equity in accordance with paragraph 106, and includes them in the initial cost or other carrying amount of the asset or liability.**

110. An entity shall adopt either (a) or (b) in paragraph 109 as its accounting policy and shall apply it consistently to all hedges to which paragraph 109 relates.
111. For cash flow hedges other than those covered by paragraphs 108 and 109, amounts that had been recognized directly in net assets/equity shall be recognized in surplus or deficit in the same period or periods during which the hedged forecast cash flows affects surplus or deficit (e.g., when a forecast sale occurs).
112. In any of the following circumstances an entity shall discontinue prospectively the hedge accounting specified in paragraphs 106–111:
- (a) The hedging instrument expires or is sold, terminated or exercised (for this purpose, the replacement or rollover of a hedging instrument into another hedging instrument is not an expiration or termination if such replacement or rollover is part of the entity's documented hedging strategy). In this case, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109, or 111 applies.
 - (b) The hedge no longer meets the criteria for hedge accounting in paragraph 98. In this case, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs. When the transaction occurs, paragraph 108, 109, or 111 applies.
 - (c) The forecast transaction is no longer expected to occur, in which case any related cumulative gain or loss on the hedging instrument that has been recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall be recognized in surplus or deficit. A forecast transaction that is no longer highly probable (see paragraph 98(c)) may still be expected to occur.
 - (d) The entity revokes the designation. For hedges of a forecast transaction, the cumulative gain or loss on the hedging instrument that remains recognized directly in net assets/equity from the period when the hedge was effective (see paragraph 106(a)) shall remain separately recognized in net assets/equity until the forecast transaction occurs or is no longer expected to occur. When the transaction occurs, paragraph 108, 109, or 111 applies. If the transaction is no longer expected to occur, the cumulative gain or

loss that had been recognized directly in net assets/equity shall be recognized in surplus or deficit.

Hedges of a Net Investment

- 113. Hedges of a net investment in a foreign operation, including a hedge of a monetary item that is accounted for as part of the net investment (see IPSAS 4), shall be accounted for similarly to cash flow hedges:**
- (a) The portion of the gain or loss on the hedging instrument that is determined to be an effective hedge (see paragraph 98) shall be recognized directly in net assets/equity through the statement of changes in net assets/equity (see IPSAS 1); and**
 - (b) The ineffective portion shall be recognized in surplus or deficit.**

The gain or loss on the hedging instrument relating to the effective portion of the hedge that has been recognized directly in net assets/equity shall be recognized in surplus or deficit in accordance with paragraphs 56–57 of IPSAS 4 on disposal of the foreign operation.

Transition

- 114. This Standard shall be applied retrospectively except as specified in paragraphs 115–123. The opening balance of accumulated surplus or deficit for the earliest prior period presented and all other comparative amounts shall be adjusted as if this Standard had always been in use unless restating the information would be impracticable. If restatement is impracticable, the entity shall disclose that fact and indicate the extent to which the information was restated.**
- 115. When this Standard is first applied, an entity is permitted to designate a financial asset, including those that may have been recognized previously, as available for sale. For any such financial asset the entity shall recognize all cumulative changes in fair value in a separate component of net assets/equity until subsequent derecognition or impairment, when the entity shall transfer that cumulative gain or loss to surplus or deficit. For financial assets that were previously recognized, the entity shall also:**
- (a) Restate the financial asset using the new designation in the comparative financial statements; and**
 - (b) Disclose the fair value of the financial assets at the date of designation and their classification and carrying amount in the previous financial statements.**
- 116. When this Standard is first applied, an entity is permitted to designate a financial asset or a financial liability, including those that may have been recognized previously, at fair value through surplus or deficit that meet the criteria for designation in paragraphs 10, 13, 14, 15, 51, AG7–AG16,**

AG47, and AG48. Where an entity previously recognized financial assets and financial liabilities, the following apply:

- (a) Notwithstanding paragraph 111, any financial assets and financial liabilities designated as at fair value through surplus or deficit in accordance with this subparagraph that were previously designated as the hedged item in fair value hedge accounting relationships shall be de-designated from those relationships at the same time they are designated as at fair value through surplus or deficit.
 - (b) Shall disclose the fair value of any financial assets or financial liabilities designated in accordance with subparagraph (a) at the date of designation and their classification and carrying amount in the previous financial statements.
 - (c) Shall de-designate any financial asset or financial liability previously designated as at fair value through surplus or deficit if it does not qualify for such designation in accordance with those paragraphs. When a financial asset or financial liability will be measured at amortized cost after de-designation, the date of de-designation is deemed to be its date of initial recognition.
 - (d) Shall disclose the fair value of any financial assets or financial liabilities de-designated in accordance with subparagraph (c) at the date of de-designation and their new classifications.
117. An entity shall restate its comparative financial statements using the new designations in paragraph 116 provided that, in the case of a financial asset, financial liability, or group of financial assets, financial liabilities or both, designated as at fair value through surplus or deficit, those items or groups would have met the criteria in paragraph 10(b)(i), 10(b)(ii), or 13 at the beginning of the comparative period or, if acquired after the beginning of the comparative period, would have met the criteria in paragraph 10(b)(i), 10(b)(ii), or 13 at the date of initial recognition.
118. Except as permitted by paragraph 119, an entity shall apply the derecognition requirements in paragraphs 17–39 and Appendix A paragraphs AG51–AG67 prospectively. If an entity derecognized financial assets under another basis of accounting as a result of a transaction that occurred before the adoption of this Standard and those assets would not have been derecognized under this Standard, it shall not recognize those assets.
119. Notwithstanding paragraph 118, an entity may apply the derecognition requirements in paragraphs 17–39 and Appendix A paragraphs AG51–AG67 retrospectively from a date of the entity’s choosing, provided that the information needed to apply this Standard to assets and liabilities

derecognized as a result of past transactions was obtained at the time of initially accounting for those transactions.

120. Notwithstanding paragraph 114, an entity may apply the requirements in the last sentence of paragraph AG108, and paragraph AG109, in either of the following ways:
 - (a) Prospectively to transactions entered into after the adoption of this Standard; or
 - (b) Retrospectively from a date of the entity's choosing, provided that the information needed to apply this Standard to assets and liabilities as a result of past transactions was obtained at the time of initially accounting for those transactions.
121. An entity shall not adjust the carrying amount of non-financial assets and non-financial liabilities to exclude gains and losses related to cash flow hedges that were included in the carrying amount before the beginning of the financial year in which this Standard is first applied. At the beginning of the financial period in which this Standard is first applied, any amount recognized directly in net assets/equity for a hedge of a firm commitment that under this Standard is accounted for as a fair value hedge shall be reclassified as an asset or liability, except for a hedge of foreign currency risk that continues to be treated as a cash flow hedge.
122. If an entity has designated as the hedged item an external forecast transaction that:
 - (a) Is denominated in the functional currency of the entity entering into the transaction;
 - (b) Gives rise to an exposure that will have an effect on consolidated surplus or deficit (i.e., is denominated in a currency other than the economic entity's presentation currency); and
 - (c) Would have qualified for hedge accounting had it not been denominated in the functional currency of the entity entering into it;

it may apply hedge accounting in the consolidated financial statements in the period(s) before the date of first application of the last sentence of paragraph 89 and paragraphs AG133 and AG134.
123. An entity need not apply paragraph AG134 to comparative information relating to periods before the date of application of the last sentence of paragraph 89 and paragraph AG133.

Effective Date

124. An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2013, it shall disclose that fact.
125. An entity shall not apply this Standard before January 1, 2013, unless it also applies IPSAS 28 and IPSAS 30.
- 125A. Paragraph 2 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 5, 7 and 107C of IPSAS 17 and the amendments to paragraphs 6 and 132A of IPSAS 31.
126. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 29.

Scope (paragraphs 2–8)

- AG1. This Standard does not change the requirements relating to employee benefit plans that comply with the relevant international or national accounting standard on accounting and reporting by retirement benefit plans and royalty agreements based on the volume of sales or service revenues that are accounted for under IPSAS 9.

Investments in Controlled Entities, Associates, and Joint Ventures

- AG2. Sometimes, an entity makes what it views as a “strategic investment” in equity instruments issued by another entity, with the intention of establishing or maintaining a long-term operating relationship with the entity in which the investment is made. The investor entity uses IPSAS 7 to determine whether the equity method of accounting is appropriate for such an investment. Similarly, the investor entity uses IPSAS 8 to determine whether proportionate consolidation or the equity method is appropriate for such an investment. If neither the equity method nor proportionate consolidation is appropriate, the entity applies this Standard to that strategic investment.

Insurance Contracts

- AG3. This Standard applies to the financial assets and financial liabilities of insurers, other than rights and obligations that paragraph 2(e) excludes because they arise from insurance contracts. An entity does however apply this Standard to:

- Financial guarantee contracts, except those where the issuer elects to treat such contracts as insurance contracts in accordance with IPSAS 28; and
- Embedded derivatives included in insurance contracts.

An entity may, but is not required to, apply this Standard to other insurance contracts that involve the transfer of financial risk.

- AG4. Financial guarantee contracts may have various legal forms, such as a guarantee, some types of letter of credit, a credit default contract or an insurance contract. Their accounting treatment does not depend on their legal form. The following are examples of the appropriate treatment (see paragraph 2(e)):

- (a) Although a financial guarantee contract meets the definition of an insurance contract if the risk transferred is significant, the issuer applies this Standard. Nevertheless, an entity may elect, under certain circumstances, to treat financial guarantee contracts as insurance contracts of financial instruments using IPSAS 28 if the issuer has previously adopted an accounting policy that treated financial guarantee contracts as insurance contracts and has used accounting applicable to insurance contracts, the issuer may elect to apply either this Standard or the relevant international or national accounting standard on insurance contracts to such financial guarantee contracts. If this Standard applies paragraph 45 requires the issuer to recognize a financial guarantee contract initially at fair value. If the financial guarantee contract was issued to an unrelated party in a stand-alone arm's length transaction, its fair value at inception is likely to equal the premium received, unless there is evidence to the contrary. Subsequently, unless the financial guarantee contract was designated at inception as at fair value through surplus or deficit or unless paragraphs 31–39 and AG62–67 apply (when a transfer of a financial asset does not qualify for derecognition or the continuing involvement approach applies), the issuer measures it at the higher of:
 - (i) The amount determined in accordance with IPSAS 19; and
 - (ii) The amount initially recognized less, when appropriate, cumulative amortization recognized in accordance with IPSAS 9 (see paragraph 49(c)).
- (b) Some credit-related guarantees do not, as a precondition for payment, require that the holder is exposed to, and has incurred a loss on, the failure of the debtor to make payments on the guaranteed asset when due. An example of such a guarantee is one that requires payments in response to changes in a specified credit rating or credit index. Such guarantees are not financial guarantee contracts, as defined in this Standard, and are not insurance contracts. Such guarantees are derivatives and the issuer applies this Standard to them.
- (c) If a financial guarantee contract was issued in connection with the sale of goods, the issuer applies IPSAS 9 in determining when it recognizes the revenue from the guarantee and from the sale of goods.

AG5. Some contracts require a payment based on climatic, geological or other physical variables. (Those based on climatic variables are sometimes referred to as “weather derivatives”). If those contracts are not insurance contracts, they are within the scope of this Standard.

Rights and Obligations Arising from Non-Exchange Revenue Transactions

- AG6. Rights and obligations (assets and liabilities) may arise from non-exchange revenue transactions, for example, an entity may receive cash from a multi-lateral agency to perform certain activities. Where the performance of those activities is subject to conditions, an asset and a liability is recognized simultaneously. Where the asset is a financial asset, it is recognized in accordance with IPSAS 23, and initially measured in accordance with IPSAS 23 and this Standard. A liability that is initially recognized as a result of conditions imposed on the use of an asset is outside the scope of this Standard and is dealt with in IPSAS 23. After initial recognition, if circumstances indicate that recognition of a liability in accordance with IPSAS 23 is no longer appropriate, an entity considers whether a financial liability should be recognized in accordance with this Standard. Other liabilities that may arise from non-exchange revenue transactions are recognized and measured in accordance with this Standard if they meet the definition of a financial liability in IPSAS 28.

Definitions (paragraphs 9 and 10)*Designation as at Fair Value through Surplus or Deficit*

- AG7. Paragraph 10 of this Standard allows an entity to designate a financial asset, a financial liability, or a group of financial instruments (financial assets, financial liabilities or both) as at fair value through surplus or deficit provided that doing so results in more relevant information.
- AG8. The decision of an entity to designate a financial asset or financial liability as at fair value through surplus or deficit is similar to an accounting policy choice (although, unlike an accounting policy choice, it is not required to be applied consistently to all similar transactions). When an entity has such a choice, paragraph 17(b) of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* requires the chosen policy to result in the financial statements providing reliable and more relevant information about the effects of transactions, other events and conditions on the entity's financial position, financial performance or cash flows. In the case of designation as at fair value through surplus or deficit, paragraph 10 sets out the two circumstances when the requirement for more relevant information will be met. Accordingly, to choose such designation in accordance with paragraph 10, the entity needs to demonstrate that it falls within one (or both) of these two circumstances.

Paragraph 10(b)(i): Designation Eliminates or Significantly Reduces a Measurement or Recognition Inconsistency that Would Otherwise Arise

- AG9. Under IPSAS 29, measurement of a financial asset or financial liability and classification of recognized changes in its value are determined by the

item's classification and whether the item is part of a designated hedging relationship. Those requirements can create a measurement or recognition inconsistency (sometimes referred to as an "accounting mismatch") when, for example, in the absence of designation as at fair value through surplus or deficit, a financial asset would be classified as available for sale (with most changes in fair value recognized directly in net assets/equity) and a liability the entity considers related would be measured at amortized cost (with changes in fair value not recognized). In such circumstances, an entity may conclude that its financial statements would provide more relevant information if both the asset and the liability were classified as at fair value through surplus or deficit.

AG10. The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through surplus or deficit only if it meets the principle in paragraph 10(b)(i).

- (a) An entity has liabilities whose cash flows are contractually based on the performance of assets that would otherwise be classified as available for sale. For example, an insurer may have liabilities containing a discretionary participation feature that pay benefits based on realized and/or unrealized investment returns of a specified pool of the insurer's assets. If the measurement of those liabilities reflects current market prices, classifying the assets as at fair value through surplus or deficit means that changes in the fair value of the financial assets are recognized in surplus or deficit in the same period as related changes in the value of the liabilities.
- (b) An entity has liabilities under insurance contracts whose measurement incorporates current information, and financial assets it considers related that would otherwise be classified as available for sale or measured at amortized cost.
- (c) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other. However, only some of the instruments would be measured at fair value through surplus or deficit (i.e., are derivatives, or are classified as held for trading). It may also be the case that the requirements for hedge accounting are not met, for example because the requirements for effectiveness in paragraph 98 are not met.
- (d) An entity has financial assets, financial liabilities or both that share a risk, such as interest rate risk, that gives rise to opposite changes in fair value that tend to offset each other and the entity does not qualify for hedge accounting because none of the instruments is a derivative. Furthermore, in the absence of hedge accounting there

is a significant inconsistency in the recognition of gains and losses. For example:

- (i) The entity has financed a portfolio of fixed rate assets that would otherwise be classified as available for sale with fixed rate debentures whose changes in fair value tend to offset each other. Reporting both the assets and the debentures at fair value through surplus or deficit corrects the inconsistency that would otherwise arise from measuring the assets at fair value with changes reported in net assets/equity and the debentures at amortized cost.
- (ii) The entity has financed a specified group of loans by issuing traded bonds whose changes in fair value tend to offset each other. If, in addition, the entity regularly buys and sells the bonds but rarely, if ever, buys and sells the loans, reporting both the loans and the bonds at fair value through surplus or deficit eliminates the inconsistency in the timing of recognition of gains and losses that would otherwise result from measuring them both at amortized cost and recognizing a gain or loss each time a bond is repurchased.

AG11. In cases such as those described in the preceding paragraph, to designate, at initial recognition, the financial assets and financial liabilities not otherwise so measured as at fair value through surplus or deficit may eliminate or significantly reduce the measurement or recognition inconsistency and produce more relevant information. For practical purposes, the entity need not enter into all of the assets and liabilities giving rise to the measurement or recognition inconsistency at exactly the same time. A reasonable delay is permitted provided that each transaction is designated as at fair value through surplus or deficit at its initial recognition and, at that time, any remaining transactions are expected to occur.

AG12. It would not be acceptable to designate only some of the financial assets and financial liabilities giving rise to the inconsistency as at fair value through surplus or deficit if to do so would not eliminate or significantly reduce the inconsistency and would therefore not result in more relevant information. However, it would be acceptable to designate only some of a number of similar financial assets or similar financial liabilities if doing so achieves a significant reduction (and possibly a greater reduction than other allowable designations) in the inconsistency. For example, assume an entity has a number of similar financial liabilities that sum to CU100¹ and a number of similar financial assets that sum to CU50 but are

¹ In this Standard, monetary amounts are denominated in “currency units” (CU).

measured on a different basis. The entity may significantly reduce the measurement inconsistency by designating at initial recognition all of the assets but only some of the liabilities (e.g., individual liabilities with a combined total of CU45) as at fair value through surplus or deficit. However, because designation as at fair value through surplus or deficit can be applied only to the whole of a financial instrument, the entity in this example must designate one or more liabilities in their entirety. It could not designate either a component of a liability (e.g., changes in value attributable to only one risk, such as changes in a benchmark interest rate) or a proportion (i.e., percentage) of a liability.

Paragraph 10(b)(ii): A Group of Financial Assets, Financial Liabilities or Both is Managed and its Performance is Evaluated on a Fair Value basis, in accordance with a Documented Risk Management or Investment Strategy

- AG13. An entity may manage and evaluate the performance of a group of financial assets, financial liabilities or both in such a way that measuring that group at fair value through surplus or deficit results in more relevant information. The focus in this instance is on the way the entity manages and evaluates performance, rather than on the nature of its financial instruments.
- AG14. The following examples show when this condition could be met. In all cases, an entity may use this condition to designate financial assets or financial liabilities as at fair value through surplus or deficit only if it meets the principle in paragraph 10(b)(ii).
- (a) The entity is a venture capital organization, mutual fund, unit trust or similar entity whose business is investing in financial assets with a view to profiting from their total return in the form of interest, dividends or similar distributions and changes in fair value. IPSAS 7 and IPSAS 8 allow such investments to be excluded from their scope provided they are measured at fair value through surplus or deficit. An entity may apply the same accounting policy to other investments managed on a total return basis but over which its influence is insufficient for them to be within the scope of IPSAS 7 or IPSAS 8.
 - (b) The entity has financial assets and financial liabilities that share one or more risks and those risks are managed and evaluated on a fair value basis in accordance with a documented policy of asset and liability management. An example could be an entity that has issued “structured products” containing multiple embedded derivatives and manages the resulting risks on a fair value basis using a mix of derivative and non-derivative financial instruments. A similar example could be an entity that originates fixed interest

rate loans and manages the resulting benchmark interest rate risk using a mix of derivative and non-derivative financial instruments.

- (c) The entity is an insurer that holds a portfolio of financial assets, manages that portfolio so as to maximize its total return (i.e., interest, dividends or similar distributions and changes in fair value), and evaluates its performance on that basis. The portfolio may be held to back specific liabilities, net assets/equity or both. If the portfolio is held to back specific liabilities, the condition in paragraph 10(b)(ii) may be met for the assets regardless of whether the insurer also manages and evaluates the liabilities on a fair value basis. The condition in paragraph 10(b)(ii) may be met when the insurer's objective is to maximize total return on the assets over the longer term even if amounts paid to holders of participating contracts depend on other factors such as the amount of gains realized in a shorter period (e.g., a year) or are subject to the insurer's discretion.

AG15. As noted above, this condition relies on the way the entity manages and evaluates performance of the group of financial instruments under consideration. Accordingly, (subject to the requirement of designation at initial recognition) an entity that designates financial instruments as at fair value through surplus or deficit on the basis of this condition shall so designate all eligible financial instruments that are managed and evaluated together.

AG16. Documentation of the entity's strategy need not be extensive but should be sufficient to demonstrate compliance with paragraph 10(b)(ii). Such documentation is not required for each individual item, but may be on a portfolio basis. For example, if the performance management system within an entity as approved by the entity's key management personnel – clearly demonstrates that its performance is evaluated on a total return basis, no further documentation is required to demonstrate compliance with paragraph 10(b)(ii).

Effective Interest Rate

AG17. In some cases, financial assets are acquired at a deep discount that reflects incurred credit losses. Entities include such incurred credit losses in the estimated cash flows when computing the effective interest rate.

AG18. When applying the effective interest method, an entity generally amortizes any fees, points paid or received, transaction costs and other premiums or discounts included in the calculation of the effective interest rate over the expected life of the instrument. However, a shorter period is used if this is the period to which the fees, points paid or received, transaction costs, premiums or discounts relate. This will be the case when the variable to

which the fees, points paid or received, transaction costs, premiums or discounts relate is repriced to market rates before the expected maturity of the instrument. In such a case, the appropriate amortization period is the period to the next such repricing date. For example, if a premium or discount on a floating rate instrument reflects interest that has accrued on the instrument since interest was last paid, or changes in market rates since the floating interest rate was reset to market rates, it will be amortized to the next date when the floating interest is reset to market rates. This is because the premium or discount relates to the period to the next interest reset date because, at that date, the variable to which the premium or discount relates (i.e., interest rates) is reset to market rates. If, however, the premium or discount results from a change in the credit spread over the floating rate specified in the instrument, or other variables that are not reset to market rates, it is amortized over the expected life of the instrument.

- AG19. For floating rate financial assets and floating rate financial liabilities, periodic re-estimation of cash flows to reflect movements in market rates of interest alters the effective interest rate. If a floating rate financial asset or floating rate financial liability is recognized initially at an amount equal to the principal receivable or payable on maturity, re-estimating the future interest payments normally has no significant effect on the carrying amount of the asset or liability.
- AG20. If an entity revises its estimates of payments or receipts, the entity shall adjust the carrying amount of the financial asset or financial liability (or group of financial instruments) to reflect actual and revised estimated cash flows. The entity recalculates the carrying amount by computing the present value of estimated future cash flows at the financial instrument's original effective interest rate or, when applicable, the revised effective interest rate calculated in accordance with paragraph 103. The adjustment is recognized in surplus or deficit as revenue or expense. If a financial asset is reclassified in accordance with paragraph 55, 57, or 58, and the entity subsequently increases its estimates of future cash receipts as a result of increased recoverability of those cash receipts, the effect of that increase shall be recognized as an adjustment to the effective interest rate from the date of the change in estimate rather than as an adjustment to the carrying amount of the asset at the date of the change in estimate.

Derivatives

- AG21. Typical examples of derivatives are futures and forward, swap and option contracts. A derivative usually has a notional amount, which is an amount of currency, a number of shares, a number of units of weight or volume or other units specified in the contract. However, a derivative instrument does not require the holder or writer to invest or receive the notional

amount at the inception of the contract. Alternatively, a derivative could require a fixed payment or payment of an amount that can change (but not proportionally with a change in the underlying) as a result of some future event that is unrelated to a notional amount. For example, a contract may require a fixed payment of CU1,000² if the six-month interbank offered rate increases by 100 basis points. Such a contract is a derivative even though a notional amount is not specified.

- AG22. The definition of a derivative in this Standard includes contracts that are settled gross by delivery of the underlying item (e.g., a forward contract to purchase a fixed rate debt instrument). An entity may have a contract to buy or sell a non-financial item that can be settled net in cash or another financial instrument or by exchanging financial instruments (e.g., a contract to buy or sell a commodity at a fixed price at a future date). Such a contract is within the scope of this Standard unless it was entered into and continues to be held for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (see paragraphs 4–6).
- AG23. One of the defining characteristics of a derivative is that it has an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors. An option contract meets that definition because the premium is less than the investment that would be required to obtain the underlying financial instrument to which the option is linked. A currency swap that requires an initial exchange of different currencies of equal fair values meets the definition because it has a zero initial net investment.
- AG24. A regular way purchase or sale gives rise to a fixed price commitment between trade date and settlement date that meets the definition of a derivative. However, because of the short duration of the commitment it is not recognized as a derivative financial instrument. Rather, this Standard provides for special accounting for such regular way contracts (see paragraphs 40 and AG68–AG71).
- AG25. The definition of a derivative refers to non-financial variables that are not specific to a party to the contract. These include an index of earthquake losses in a particular region and an index of temperatures in a particular city. Non-financial variables specific to a party to the contract include the occurrence or non-occurrence of a fire that damages or destroys an asset of a party to the contract. A change in the fair value of a non-financial asset is specific to the owner if the fair value reflects not only changes in market prices for such assets (a financial variable) but also the condition of the specific non-financial asset held (a non-financial variable). For

² In this Standard, monetary amounts are denominated in “currency units” (CU).

example, if a guarantee of the residual value of a specific car exposes the guarantor to the risk of changes in the car's physical condition, the change in that residual value is specific to the owner of the car.

Transaction Costs

AG26. Transaction costs include fees and commissions paid to agents (including employees acting as selling agents), advisers, brokers, and dealers, levies by regulatory agencies and securities exchanges, and transfer taxes and duties. Transaction costs do not include debt premiums or discounts, financing costs, or internal administrative or holding costs.

Financial Assets and Financial Liabilities Held for Trading

AG27. Trading generally reflects active and frequent buying and selling, and financial instruments held for trading generally are used with the objective of generating a profit from short-term fluctuations in price or dealer's margin.

AG28. Financial liabilities held for trading include:

- (a) Derivative liabilities that are not accounted for as hedging instruments;
- (b) Obligations to deliver financial assets borrowed by a short seller (i.e., an entity that sells financial assets it has borrowed and does not yet own);
- (c) Financial liabilities that are incurred with an intention to repurchase them in the near term (e.g., a quoted debt instrument that the issuer may buy back in the near term depending on changes in its fair value); and
- (d) Financial liabilities that are part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent pattern of short-term profit-taking.

The fact that a liability is used to fund trading activities does not in itself make that liability one that is held for trading.

Held-to-Maturity Investments

AG29. An entity does not have a positive intention to hold to maturity an investment in a financial asset with a fixed maturity if:

- (a) The entity intends to hold the financial asset for an undefined period;
- (b) The entity stands ready to sell the financial asset (other than if a situation arises that is non-recurring and could not have been reasonably anticipated by the entity) in response to changes in

market interest rates or risks, liquidity needs, changes in the availability of and the yield on alternative investments, changes in financing sources, and terms or changes in foreign currency risk; or

- (c) The issuer has a right to settle the financial asset at an amount significantly below its amortized cost.

- AG30. A debt instrument with a variable interest rate can satisfy the criteria for a held-to-maturity investment. Equity instruments cannot be held-to-maturity investments either because they have an indefinite life (such as ordinary shares) or because the amounts the holder may receive can vary in a manner that is not predetermined (such as for share options, warrants and similar rights). With respect to the definition of held-to-maturity investments, fixed or determinable payments and fixed maturity mean that a contractual arrangement defines the amounts and dates of payments to the holder, such as interest and principal payments. A significant risk of non-payment does not preclude classification of a financial asset as held to maturity as long as its contractual payments are fixed or determinable and the other criteria for that classification are met. If the terms of a perpetual debt instrument provide for interest payments for an indefinite period, the instrument cannot be classified as held to maturity because there is no maturity date.
- AG31. The criteria for classification as a held-to-maturity investment are met for a financial asset that is callable by the issuer if the holder intends and is able to hold it until it is called or until maturity and the holder would recover substantially all of its carrying amount. The call option of the issuer, if exercised, simply accelerates the asset's maturity. However, if the financial asset is callable on a basis that would result in the holder not recovering substantially all of its carrying amount, the financial asset cannot be classified as a held-to-maturity investment. The entity considers any premium paid and capitalized transaction costs in determining whether the carrying amount would be substantially recovered.
- AG32. A financial asset that is puttable (i.e., the holder has the right to require that the issuer repay or redeem the financial asset before maturity) cannot be classified as a held-to-maturity investment because paying for a put feature in a financial asset is inconsistent with expressing an intention to hold the financial asset until maturity.
- AG33. For most financial assets, fair value is a more appropriate measure than amortized cost. The held-to-maturity classification is an exception, but only if the entity has a positive intention and the ability to hold the investment to maturity. When an entity's actions cast doubt on its intention and ability to hold such investments to maturity, paragraph 10 precludes the use of the exception for a reasonable period of time.

- AG34. A disaster scenario that is only remotely possible, such as a run on a bank or a similar situation affecting an insurer, is not something that is assessed by an entity in deciding whether it has the positive intention and ability to hold an investment to maturity.
- AG35. Sales before maturity could satisfy the condition in paragraph 10 – and therefore not raise a question about the entity’s intention to hold other investments to maturity – if they are attributable to any of the following:
- (a) A significant deterioration in the issuer’s creditworthiness. For example, a sale following a downgrade in a credit rating by an external rating agency would not necessarily raise a question about the entity’s intention to hold other investments to maturity if the downgrade provides evidence of a significant deterioration in the issuer’s creditworthiness judged by reference to the credit rating at initial recognition. Similarly, if an entity uses internal ratings for assessing exposures, changes in those internal ratings may help to identify issuers for which there has been a significant deterioration in creditworthiness, provided the entity’s approach to assigning internal ratings and changes in those ratings give a consistent, reliable and objective measure of the credit quality of the issuers. If there is evidence that a financial asset is impaired (see paragraphs 67 and 68), the deterioration in creditworthiness is often regarded as significant.
 - (b) A change in tax law that eliminates or significantly reduces the tax-exempt status of interest on the held-to-maturity investment (but not a change in tax law that revises the marginal tax rates applicable to interest revenue).
 - (c) A major entity combination or major disposition (such as a sale of a segment) that necessitates the sale or transfer of held-to-maturity investments to maintain the entity’s existing interest rate risk position or credit risk policy (although the entity combination is an event within the entity’s control, the changes to its investment portfolio to maintain an interest rate risk position or credit risk policy may be consequential rather than anticipated).
 - (d) A change in statutory or regulatory requirements significantly modifying either what constitutes a permissible investment or the maximum level of particular types of investments, thereby causing an entity to dispose of a held-to-maturity investment.
 - (e) A significant increase in the industry’s regulatory capital requirements that causes the entity to downsize by selling held-to-maturity investments.

- (f) A significant increase in the risk weights of held-to-maturity investments used for regulatory risk-based capital purposes.
- AG36. An entity does not have a demonstrated ability to hold to maturity an investment in a financial asset with a fixed maturity if:
- (a) It does not have the financial resources available to continue to finance the investment until maturity; or
 - (b) It is subject to an existing legal or other constraint that could frustrate its intention to hold the financial asset to maturity. (However, an issuer's call option does not necessarily frustrate an entity's intention to hold a financial asset to maturity—see paragraph AG31).
- AG37. Circumstances other than those described in paragraphs AG29–AG36 can indicate that an entity does not have a positive intention or the ability to hold an investment to maturity.
- AG38. An entity assesses its intention and ability to hold its held-to-maturity investments to maturity not only when those financial assets are initially recognized, but also at the end of each subsequent reporting period.

Loans and Receivables

- AG39. Any non-derivative financial asset with fixed or determinable payments (including loan assets, receivables, investments in debt instruments and deposits held in banks) could potentially meet the definition of loans and receivables. However, a financial asset that is quoted in an active market (such as a quoted debt instrument, see paragraph AG103) does not qualify for classification as a loan or receivable. Financial assets that do not meet the definition of loans and receivables may be classified as held-to-maturity investments if they meet the conditions for that classification (see paragraphs 10 and AG29–AG38). On initial recognition of a financial asset that would otherwise be classified as a loan or receivable, an entity may designate it as a financial asset at fair value through surplus or deficit, or available for sale.

Embedded Derivatives (paragraphs 11–13)

- AG40. If a host contract has no stated or predetermined maturity and represents a residual interest in the net assets of an entity, then its economic characteristics and risks are those of an equity instrument, and an embedded derivative would need to possess characteristics of the net assets/equity related to the same entity to be regarded as closely related. If the host contract is not an equity instrument and meets the definition of a financial instrument, then its economic characteristics and risks are those of a debt instrument.

- AG41. An embedded non-option derivative (such as an embedded forward or swap) is separated from its host contract on the basis of its stated or implied substantive terms, so as to result in it having a fair value of zero at initial recognition. An embedded option-based derivative (such as an embedded put, call, cap, floor, or swaption) is separated from its host contract on the basis of the stated terms of the option feature. The initial carrying amount of the host instrument is the residual amount after separating the embedded derivative.
- AG42. Generally, multiple embedded derivatives in a single instrument are treated as a single compound embedded derivative. However, embedded derivatives that are classified as equity instruments (see IPSAS 28) are accounted for separately from those classified as assets or liabilities. In addition, if an instrument has more than one embedded derivative and those derivatives relate to different risk exposures and are readily separable and independent of each other, they are accounted for separately from each other.
- AG43. The economic characteristics and risks of an embedded derivative are not closely related to the host contract (paragraph 12(a)) in the following examples. In these examples, assuming the conditions in paragraph 12(b) and (c) are met, an entity accounts for the embedded derivative separately from the host contract.
- (a) A put option embedded in an instrument that enables the holder to require the issuer to reacquire the instrument for an amount of cash or other assets that varies on the basis of the change in an equity or commodity price or index is not closely related to a host debt instrument.
 - (b) A call option embedded in an equity instrument that enables the issuer to reacquire that equity instrument at a specified price is not closely related to the host equity instrument from the perspective of the holder (from the issuer's perspective, the call option is an equity instrument provided it meets the conditions for that classification under IPSAS 28, in which case it is excluded from the scope of this Standard).
 - (c) An option or automatic provision to extend the remaining term to maturity of a debt instrument is not closely related to the host debt instrument unless there is a concurrent adjustment to the approximate current market rate of interest at the time of the extension. If an entity issues a debt instrument and the holder of that debt instrument writes a call option on the debt instrument to a third party, the issuer regards the call option as extending the term to maturity of the debt instrument provided the issuer can be

required to participate in or facilitate the remarketing of the debt instrument as a result of the call option being exercised.

- (d) Equity-indexed interest or principal payments embedded in a host debt instrument or insurance contract – by which the amount of interest or principal is indexed to the value of equity instruments – are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.
- (e) Commodity-indexed interest or principal payments embedded in a host debt instrument or insurance contract – by which the amount of interest or principal is indexed to the price of a commodity (such as oil – are not closely related to the host instrument because the risks inherent in the host and the embedded derivative are dissimilar.
- (f) An equity conversion feature embedded in a convertible debt instrument is not closely related to the host debt instrument from the perspective of the holder of the instrument (from the issuer's perspective, the equity conversion option is an equity instrument and excluded from the scope of this Standard provided it meets the conditions for that classification under IPSAS 28).
- (g) A call, put, or prepayment option embedded in a host debt contract or host insurance contract is not closely related to the host contract unless the option's exercise price is approximately equal on each exercise date to the amortized cost of the host debt instrument or the carrying amount of the host insurance contract. From the perspective of the issuer of a convertible debt instrument with an embedded call or put option feature, the assessment of whether the call or put option is closely related to the host debt contract is made before separating the element of net assets/equity under IPSAS 28.
- (h) Credit derivatives that are embedded in a host debt instrument and allow one party (the "beneficiary") to transfer the credit risk of a particular reference asset, which it may not own, to another party (the "guarantor") are not closely related to the host debt instrument. Such credit derivatives allow the guarantor to assume the credit risk associated with the reference asset without directly owning it.

AG44. An example of a hybrid instrument is a financial instrument that gives the holder a right to put the financial instrument back to the issuer in exchange for an amount of cash or other financial assets that varies on the basis of the change in an equity or commodity index that may increase or decrease (a "puttable instrument"). Unless the issuer on initial recognition designates the puttable instrument as a financial liability at fair value through surplus or deficit, it is required to separate an embedded derivative (i.e., the indexed principal payment) under paragraph 12

because the host contract is a debt instrument under paragraph AG40 and the indexed principal payment is not closely related to a host debt instrument under paragraph AG43(a). Because the principal payment can increase and decrease, the embedded derivative is a non-option derivative whose value is indexed to the underlying variable.

- AG45. In the case of a puttable instrument that can be put back at any time for cash equal to a proportionate share of the net asset value of an entity (such as units of an open-ended mutual fund or some unit-linked investment products), the effect of separating an embedded derivative and accounting for each component is to measure the combined instrument at the redemption amount that is payable at the end of the reporting period if the holder exercised its right to put the instrument back to the issuer.
- AG46. The economic characteristics and risks of an embedded derivative are closely related to the economic characteristics and risks of the host contract in the following examples. In these examples, an entity does not account for the embedded derivative separately from the host contract.
- (a) An embedded derivative in which the underlying is an interest rate or interest rate index that can change the amount of interest that would otherwise be paid or received on an interest-bearing host debt contract or insurance contract is closely related to the host contract unless the combined instrument can be settled in such a way that the holder would not recover substantially all of its recognized investment or the embedded derivative could at least double the holder's initial rate of return on the host contract and could result in a rate of return that is at least twice what the market return would be for a contract with the same terms as the host contract.
 - (b) An embedded floor or cap on the interest rate on a debt contract or insurance contract is closely related to the host contract, provided the cap is at or above the market rate of interest and the floor is at or below the market rate of interest when the contract is issued, and the cap or floor is not leveraged in relation to the host contract. Similarly, provisions included in a contract to purchase or sell an asset (e.g., a commodity) that establish a cap and a floor on the price to be paid or received for the asset are closely related to the host contract if both the cap and floor were out of the money at inception and are not leveraged.
 - (c) An embedded foreign currency derivative that provides a stream of principal or interest payments that are denominated in a foreign currency and is embedded in a host debt instrument (e.g., a dual currency bond) is closely related to the host debt instrument. Such a derivative is not separated from the host instrument because

IPSAS 4 requires foreign currency gains and losses on monetary items to be recognized in surplus or deficit.

- (d) An embedded foreign currency derivative in a host contract that is an insurance contract or not a financial instrument (such as a contract for the purchase or sale of a non-financial item where the price is denominated in a foreign currency) is closely related to the host contract provided it is not leveraged, does not contain an option feature, and requires payments denominated in one of the following currencies:
 - (i) The functional currency of any substantial party to that contract;
 - (ii) The currency in which the price of the related good or service that is acquired or delivered is routinely denominated in commercial transactions around the world (such as the US dollar for crude oil transactions); or
 - (iii) A currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place (e.g., a relatively stable and liquid currency that is commonly used in local transactions or external trade).
- (e) An embedded prepayment option in an interest – only or principal-only strip is closely related to the host contract provided the host contract (i) initially resulted from separating the right to receive contractual cash flows of a financial instrument that, in and of itself, did not contain an embedded derivative, and (ii) does not contain any terms not present in the original host debt contract.
- (f) An embedded derivative in a host lease contract is closely related to the host contract if the embedded derivative is (i) an inflation-related index such as an index of lease payments to a consumer price index (provided that the lease is not leveraged and the index relates to inflation in the entity's own economic environment), (ii) contingent rentals based on related sales, or (iii) contingent rentals based on variable interest rates.
- (g) A unit-linking feature embedded in a host financial instrument or host insurance contract is closely related to the host instrument or host contract if the unit-denominated payments are measured at current unit values that reflect the fair values of the assets of the fund. A unit-linking feature is a contractual term that requires payments denominated in units of an internal or external investment fund.

- (h) A derivative embedded in an insurance contract is closely related to the host insurance contract if the embedded derivative and host insurance contract are so interdependent that an entity cannot measure the embedded derivative separately (i.e., without considering the host contract).

Instruments Containing Embedded Derivatives

- AG47. When an entity becomes a party to a hybrid (combined) instrument that contains one or more embedded derivatives, paragraph 12 requires the entity to identify any such embedded derivative, assess whether it is required to be separated from the host contract and, for those that are required to be separated, measure the derivatives at fair value at initial recognition and subsequently. These requirements can be more complex, or result in less reliable measures, than measuring the entire instrument at fair value through surplus or deficit. For that reason this Standard permits the entire instrument to be designated as at fair value through surplus or deficit.
- AG48. Such designation may be used whether paragraph 12 requires the embedded derivatives to be separated from the host contract or prohibits such separation. However, paragraph 13 would not justify designating the hybrid (combined) instrument as at fair value through surplus or deficit in the cases set out in paragraph 12(a) and (b) because doing so would not reduce complexity or increase reliability.

Recognition and Derecognition (paragraphs 16–44)

Initial Recognition (paragraph 16)

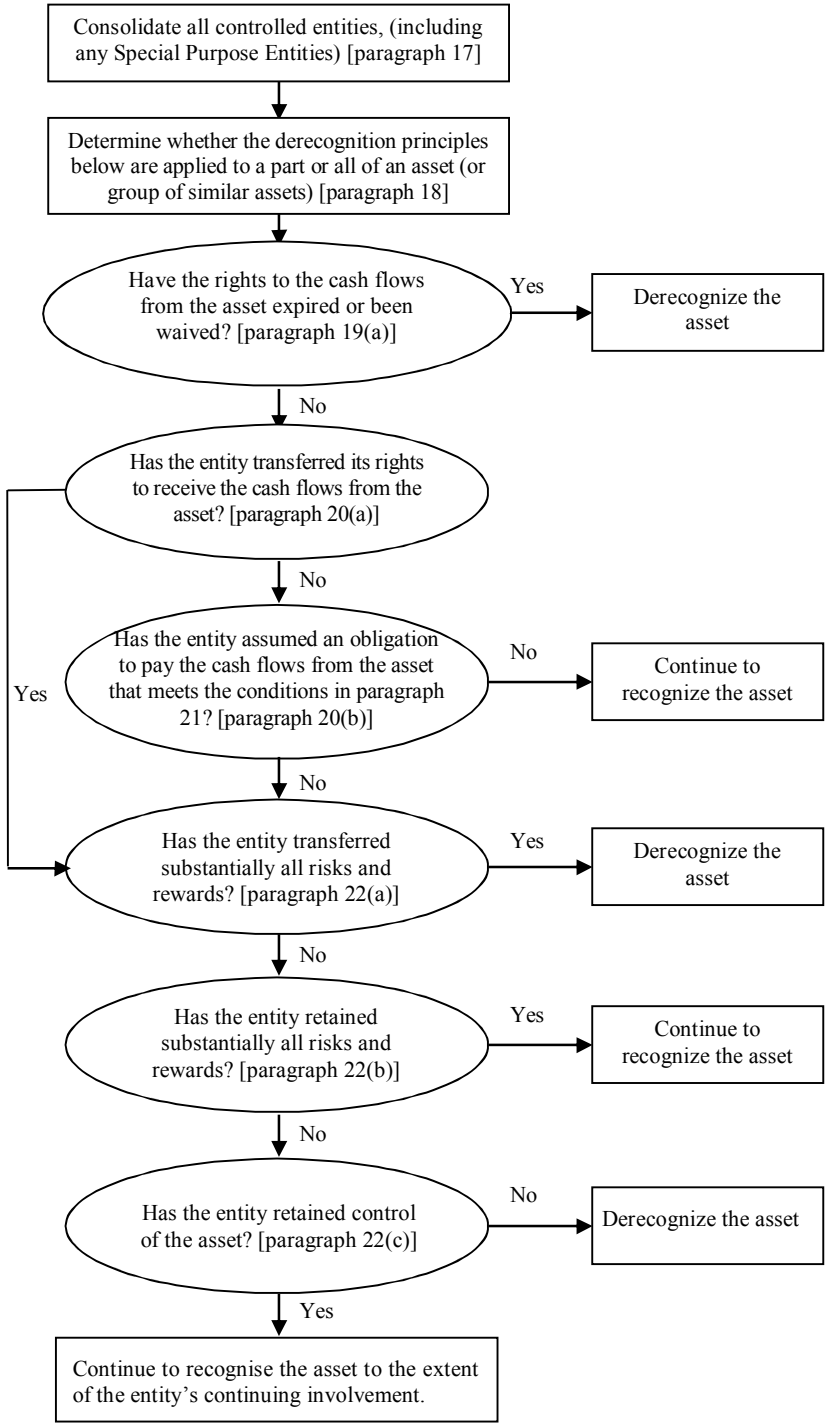
- AG49. As a consequence of the principle in paragraph 16, an entity recognizes all of its contractual rights and obligations under derivatives in its statement of financial position as assets and liabilities, respectively, except for derivatives that prevent a transfer of financial assets from being accounted for as a sale (see paragraph AG64). If a transfer of a financial asset does not qualify for derecognition, the transferee does not recognize the transferred asset as its asset (see paragraph AG65).
- AG50. The following are examples of applying the principle in paragraph 16:
- (a) Unconditional receivables and payables are recognized as assets or liabilities when the entity becomes a party to the contract and, as a consequence, has a legal right to receive or a legal obligation to pay cash.
 - (b) Assets to be acquired and liabilities to be incurred as a result of a firm commitment to purchase or sell goods or services are generally not recognized until at least one of the parties has performed under the agreement. For example, an entity that

receives a firm order does not generally recognize an asset (and the entity that places the order does not recognize a liability) at the time of the commitment but, rather, delays recognition until the ordered goods or services have been shipped, delivered or rendered. If a firm commitment to buy or sell non-financial items is within the scope of this Standard under paragraphs 4–6, its net fair value is recognized as an asset or liability on the commitment date (see (c) below). In addition, if a previously unrecognized firm commitment is designated as a hedged item in a fair value hedge, any change in the net fair value attributable to the hedged risk is recognized as an asset or liability after the inception of the hedge (see paragraphs 104 and 105).

- (c) A forward contract that is within the scope of this Standard (see paragraphs 2–6) is recognized as an asset or a liability on the commitment date, rather than on the date on which settlement takes place. When an entity becomes a party to a forward contract, the fair values of the right and obligation are often equal, so that the net fair value of the forward is zero. If the net fair value of the right and obligation is not zero, the contract is recognized as an asset or liability.
- (d) Option contracts that are within the scope of this Standard (see paragraphs 2–6) are recognized as assets or liabilities when the holder or writer becomes a party to the contract.
- (e) Planned future transactions, no matter how likely, are not assets and liabilities because the entity has not become a party to a contract.

Derecognition of a Financial Asset (paragraphs 17–39)

- AG51. The following flow chart illustrates the evaluation of whether and to what extent a financial asset is derecognized.



Arrangements under Which an Entity Retains the Contractual Rights to Receive the Cash Flows of a Financial Asset, but Assumes a Contractual Obligation to Pay the Cash Flows to One or More Recipients (paragraph 20(b))

- AG52. The situation described in paragraph 20(b) (when an entity retains the contractual rights to receive the cash flows of the financial asset, but assumes a contractual obligation to pay the cash flows to one or more recipients) occurs, for example, if the entity is a special purpose entity (SPE) or trust, and issues to investors beneficial interests in the underlying financial assets that it owns and provides servicing of those financial assets. In that case, the financial assets qualify for derecognition if the conditions in paragraphs 21 and 22 are met.
- AG53. In applying paragraph 21, the entity could be, for example, the originator of the financial asset, or it could be a group that includes a consolidated SPE that has acquired the financial asset and passes on cash flows to unrelated third party investors.

Evaluation of the Transfer of Risks and Rewards of Ownership (paragraph 22)

- AG54. Examples of when an entity has transferred substantially all the risks and rewards of ownership are:
- (a) An unconditional sale of a financial asset;
 - (b) A sale of a financial asset together with an option to repurchase the financial asset at its fair value at the time of repurchase; and
 - (c) A sale of a financial asset together with a put or call option that is deeply out of the money (i.e., an option that is so far out of the money it is highly unlikely to go into the money before expiry).
- AG55. Examples of when an entity has retained substantially all the risks and rewards of ownership are:
- (a) A sale and repurchase transaction where the repurchase price is a fixed price or the sale price plus a lender's return;
 - (b) A securities lending agreement;
 - (c) A sale of a financial asset together with a total return swap that transfers the market risk exposure back to the entity;
 - (d) A sale of a financial asset together with a deep in-the-money put or call option (i.e., an option that is so far in the money that it is highly unlikely to go out of the money before expiry); and
 - (e) A sale of short-term receivables in which the entity guarantees to compensate the transferee for credit losses that are likely to occur.

- AG56. If an entity determines that as a result of the transfer, it has transferred substantially all the risks and rewards of ownership of the transferred asset, it does not recognize the transferred asset again in a future period, unless it reacquires the transferred asset in a new transaction.

Evaluation of the Transfer of Control

- AG57. An entity has not retained control of a transferred asset if the transferee has the practical ability to sell the transferred asset. An entity has retained control of a transferred asset if the transferee does not have the practical ability to sell the transferred asset. A transferee has the practical ability to sell the transferred asset if it is traded in an active market because the transferee could repurchase the transferred asset in the market if it needs to return the asset to the entity. For example, a transferee may have the practical ability to sell a transferred asset if the transferred asset is subject to an option that allows the entity to repurchase it, but the transferee can readily obtain the transferred asset in the market if the option is exercised. A transferee does not have the practical ability to sell the transferred asset if the entity retains such an option and the transferee cannot readily obtain the transferred asset in the market if the entity exercises its option.
- AG58. The transferee has the practical ability to sell the transferred asset only if the transferee can sell the transferred asset in its entirety to an unrelated third party and is able to exercise that ability unilaterally and without imposing additional restrictions on the transfer. The critical question is what the transferee is able to do in practice, not what contractual rights the transferee has concerning what it can do with the transferred asset or what contractual prohibitions exist. In particular:
- (a) A contractual right to dispose of the transferred asset has little practical effect if there is no market for the transferred asset; and
 - (b) An ability to dispose of the transferred asset has little practical effect if it cannot be exercised freely. For that reason:
 - (i) The transferee's ability to dispose of the transferred asset must be independent of the actions of others (i.e., it must be a unilateral ability); and
 - (ii) The transferee must be able to dispose of the transferred asset without needing to attach restrictive conditions or "strings" to the transfer (e.g., conditions about how a loan asset is serviced or an option giving the transferee the right to repurchase the asset).
- AG59. That the transferee is unlikely to sell the transferred asset does not, of itself, mean that the transferor has retained control of the transferred asset. However, if a put option or guarantee constrains the transferee from

selling the transferred asset, then the transferor has retained control of the transferred asset. For example, if a put option or guarantee is sufficiently valuable it constrains the transferee from selling the transferred asset because the transferee would, in practice, not sell the transferred asset to a third party without attaching a similar option or other restrictive conditions. Instead, the transferee would hold the transferred asset so as to obtain payments under the guarantee or put option. Under these circumstances the transferor has retained control of the transferred asset.

Transfers that Qualify for Derecognition

- AG60. An entity may retain the right to a part of the interest payments on transferred assets as compensation for servicing those assets. The part of the interest payments that the entity would give up upon termination or transfer of the servicing contract is allocated to the servicing asset or servicing liability. The part of the interest payments that the entity would not give up is an interest-only strip receivable. For example, if the entity would not give up any interest upon termination or transfer of the servicing contract, the entire interest spread is an interest-only strip receivable. For the purposes of applying paragraph 29, the fair values of the servicing asset and interest-only strip receivable are used to allocate the carrying amount of the receivable between the part of the asset that is derecognized and the part that continues to be recognized. If there is no servicing fee specified or the fee to be received is not expected to compensate the entity adequately for performing the servicing, a liability for the servicing obligation is recognized at fair value.
- AG61. In estimating the fair values of the part that continues to be recognized and the part that is derecognized for the purposes of applying paragraph 29, an entity applies the fair value measurement requirements in paragraphs 50–52 and AG101–AG115 in addition to paragraph 30.

Transfers that do not Qualify for Derecognition

- AG62. The following is an application of the principle outlined in paragraph 31. If a guarantee provided by the entity for default losses on the transferred asset prevents a transferred asset from being derecognized because the entity has retained substantially all the risks and rewards of ownership of the transferred asset, the transferred asset continues to be recognized in its entirety and the consideration received is recognized as a liability.

Continuing Involvement in Transferred Assets

- AG63. The following are examples of how an entity measures a transferred asset and the associated liability under paragraph 32.

All assets

- (a) If a guarantee provided by an entity to pay for default losses on a transferred asset prevents the transferred asset from being derecognized to the extent of the continuing involvement, the transferred asset at the date of the transfer is measured at the lower of (i) the carrying amount of the asset and (ii) the maximum amount of the consideration received in the transfer that the entity could be required to repay ("the guarantee amount"). The associated liability is initially measured at the guarantee amount plus the fair value of the guarantee (which is normally the consideration received for the guarantee). Subsequently, the initial fair value of the guarantee is recognized in surplus or deficit on a time proportion basis (see IPSAS 9) and the carrying value of the asset is reduced by any impairment losses.

Assets measured at amortized cost

- (b) If a put option obligation written by an entity or call option right held by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at amortized cost, the associated liability is measured at its cost (i.e., the consideration received) adjusted for the amortization of any difference between that cost and the amortized cost of the transferred asset at the expiration date of the option. For example, assume that the amortized cost and carrying amount of the asset on the date of the transfer is CU98 and that the consideration received is CU95. The amortized cost of the asset on the option exercise date will be CU100. The initial carrying amount of the associated liability is CU95 and the difference between CU95 and CU100 is recognized in surplus or deficit using the effective interest method. If the option is exercised, any difference between the carrying amount of the associated liability and the exercise price is recognized in surplus or deficit.

Assets measured at fair value

- (c) If a call option right retained by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at fair value, the asset continues to be measured at its fair value. The associated liability is measured at (i) the option exercise price less the time value of the option if the option is in or at the money, or (ii) the fair value of the transferred asset less the time value of the option if the option is out of the money. The adjustment to the measurement of the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the call option right. For example, if the fair

value of the underlying asset is CU80, the option exercise price is CU95 and the time value of the option is CU5, the carrying amount of the associated liability is CU75 (CU80 – CU5) and the carrying amount of the transferred asset is CU80 (i.e., its fair value).

- (d) If a put option written by an entity prevents a transferred asset from being derecognized and the entity measures the transferred asset at fair value, the associated liability is measured at the option exercise price plus the time value of the option. The measurement of the asset at fair value is limited to the lower of the fair value and the option exercise price because the entity has no right to increases in the fair value of the transferred asset above the exercise price of the option. This ensures that the net carrying amount of the asset and the associated liability is the fair value of the put option obligation. For example, if the fair value of the underlying asset is CU120, the option exercise price is CU100 and the time value of the option is CU5, the carrying amount of the associated liability is CU105 (CU100 + CU5) and the carrying amount of the asset is CU100 (in this case the option exercise price).

If a collar, in the form of a purchased call and written put, prevents a transferred asset from being derecognized and the entity measures the asset at fair value, it continues to measure the asset at fair value. The associated liability is measured at (i) the sum of the call exercise price and fair value of the put option less the time value of the call option, if the call option is in or at the money, or (ii) the sum of the fair value of the asset and the fair value of the put option less the time value of the call option if the call option is out of the money. The adjustment to the associated liability ensures that the net carrying amount of the asset and the associated liability is the fair value of the options held and written by the entity. For example, assume an entity transfers a financial asset that is measured at fair value while simultaneously purchasing a call with an exercise price of CU120 and writing a put with an exercise price of CU80. Assume also that the fair value of the asset is CU100 at the date of the transfer. The time value of the put and call are CU1 and CU5 respectively. In this case, the entity recognizes an asset of CU100 (the fair value of the asset) and a liability of CU96 [(CU100 + CU1) – CU5]. This gives a net asset value of CU4, which is the fair value of the options held and written by the entity.

All Transfers

- AG64. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferor's contractual rights or obligations related to the transfer are not accounted for separately as derivatives if recognizing both the derivative and either the transferred asset or the liability arising

from the transfer would result in recognizing the same rights or obligations twice. For example, a call option retained by the transferor may prevent a transfer of financial assets from being accounted for as a sale. In that case, the call option is not separately recognized as a derivative asset.

- AG65. To the extent that a transfer of a financial asset does not qualify for derecognition, the transferee does not recognize the transferred asset as its asset. The transferee derecognizes the cash or other consideration paid and recognizes a receivable from the transferor. If the transferor has both a right and an obligation to reacquire control of the entire transferred asset for a fixed amount (such as under a repurchase agreement), the transferee may account for its receivable as a loan or receivable.

Examples

- AG66. The following examples illustrate the application of the derecognition principles of this Standard.
- (a) Repurchase agreements and securities lending. If a financial asset is sold under an agreement to repurchase it at a fixed price or at the sale price plus a lender's return or if it is loaned under an agreement to return it to the transferor, it is not derecognized because the transferor retains substantially all the risks and rewards of ownership. If the transferee obtains the right to sell or pledge the asset, the transferor reclassifies the asset in its statement of financial position, for example, as a loaned asset or repurchase receivable.
 - (b) Repurchase agreements and securities lending—assets that are substantially the same. If a financial asset is sold under an agreement to repurchase the same or substantially the same asset at a fixed price or at the sale price plus a lender's return or if a financial asset is borrowed or loaned under an agreement to return the same or substantially the same asset to the transferor, it is not derecognized because the transferor retains substantially all the risks and rewards of ownership.
 - (c) Repurchase agreements and securities lending—right of substitution. If a repurchase agreement at a fixed repurchase price or a price equal to the sale price plus a lender's return, or a similar securities lending transaction, provides the transferee with a right to substitute assets that are similar and of equal fair value to the transferred asset at the repurchase date, the asset sold or lent under a repurchase or securities lending transaction is not derecognized because the transferor retains substantially all the risks and rewards of ownership.

- (d) Repurchase right of first refusal at fair value. If an entity sells a financial asset and retains only a right of first refusal to repurchase the transferred asset at fair value if the transferee subsequently sells it, the entity derecognizes the asset because it has transferred substantially all the risks and rewards of ownership.
- (e) Wash sale transaction. The repurchase of a financial asset shortly after it has been sold is sometimes referred to as a wash sale. Such a repurchase does not preclude derecognition provided that the original transaction met the derecognition requirements. However, if an agreement to sell a financial asset is entered into concurrently with an agreement to repurchase the same asset at a fixed price or the sale price plus a lender's return, then the asset is not derecognized.
- (f) Put options and call options that are deeply in the money. If a transferred financial asset can be called back by the transferor and the call option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership. Similarly, if the financial asset can be put back by the transferee and the put option is deeply in the money, the transfer does not qualify for derecognition because the transferor has retained substantially all the risks and rewards of ownership.
- (g) Put options and call options that are deeply out of the money. A financial asset that is transferred subject only to a deep out-of-the-money put option held by the transferee or a deep out-of-the-money call option held by the transferor is derecognized. This is because the transferor has transferred substantially all the risks and rewards of ownership.
- (h) Readily obtainable assets subject to a call option that is neither deeply in the money nor deeply out of the money. If an entity holds a call option on an asset that is readily obtainable in the market and the option is neither deeply in the money nor deeply out of the money, the asset is derecognized. This is because the entity (i) has neither retained nor transferred substantially all the risks and rewards of ownership, and (ii) has not retained control. However, if the asset is not readily obtainable in the market, derecognition is precluded to the extent of the amount of the asset that is subject to the call option because the entity has retained control of the asset.
- (i) A not readily obtainable asset subject to a put option written by an entity that is neither deeply in the money nor deeply out of the money. If an entity transfers a financial asset that is not readily obtainable in the market, and writes a put option that is not deeply

out of the money, the entity neither retains nor transfers substantially all the risks and rewards of ownership because of the written put option. The entity retains control of the asset if the put option is sufficiently valuable to prevent the transferee from selling the asset, in which case the asset continues to be recognized to the extent of the transferor's continuing involvement (see paragraph AG64). The entity transfers control of the asset if the put option is not sufficiently valuable to prevent the transferee from selling the asset, in which case the asset is derecognized.

- (j) Assets subject to a fair value put or call option or a forward repurchase agreement. A transfer of a financial asset that is subject only to a put or call option or a forward repurchase agreement that has an exercise or repurchase price equal to the fair value of the financial asset at the time of repurchase results in derecognition because of the transfer of substantially all the risks and rewards of ownership.
- (k) Cash settled call or put options. An entity evaluates the transfer of a financial asset that is subject to a put or call option or a forward repurchase agreement that will be settled net in cash to determine whether it has retained or transferred substantially all the risks and rewards of ownership. If the entity has not retained substantially all the risks and rewards of ownership of the transferred asset, it determines whether it has retained control of the transferred asset. That the put or the call or the forward repurchase agreement is settled net in cash does not automatically mean that the entity has transferred control (see paragraphs AG59 and (g), (h) and (i) above).
- (l) Removal of accounts provision. A removal of accounts provision is an unconditional repurchase (call) option that gives an entity the right to reclaim assets transferred subject to some restrictions. Provided that such an option results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership, it precludes derecognition only to the extent of the amount subject to repurchase (assuming that the transferee cannot sell the assets). For example, if the carrying amount and proceeds from the transfer of loan assets are CU100,000 and any individual loan could be called back but the aggregate amount of loans that could be repurchased could not exceed CU10,000, CU90,000 of the loans would qualify for derecognition.
- (m) Clean-up calls. An entity, which may be a transferor, that services transferred assets may hold a clean-up call to purchase remaining transferred assets when the amount of outstanding assets falls to a specified level at which the cost of servicing those assets becomes

burdensome in relation to the benefits of servicing. Provided that such a clean-up call results in the entity neither retaining nor transferring substantially all the risks and rewards of ownership and the transferee cannot sell the assets, it precludes derecognition only to the extent of the amount of the assets that is subject to the call option.

- (n) Subordinated retained interests and credit guarantees. An entity may provide the transferee with credit enhancement by subordinating some or all of its interest retained in the transferred asset. Alternatively, an entity may provide the transferee with credit enhancement in the form of a credit guarantee that could be unlimited or limited to a specified amount. If the entity retains substantially all the risks and rewards of ownership of the transferred asset, the asset continues to be recognized in its entirety. If the entity retains some, but not substantially all, of the risks and rewards of ownership and has retained control, derecognition is precluded to the extent of the amount of cash or other assets that the entity could be required to pay.
- (o) Total return swaps. An entity may sell a financial asset to a transferee and enter into a total return swap with the transferee, whereby all of the interest payment cash flows from the underlying asset are remitted to the entity in exchange for a fixed payment or variable rate payment and any increases or declines in the fair value of the underlying asset are absorbed by the entity. In such a case, derecognition of all of the asset is prohibited.
- (p) Interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset and enter into an interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount that is equal to the principal amount of the transferred financial asset. The interest rate swap does not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on payments being made on the transferred asset.
- (q) Amortizing interest rate swaps. An entity may transfer to a transferee a fixed rate financial asset that is paid off over time, and enter into an amortizing interest rate swap with the transferee to receive a fixed interest rate and pay a variable interest rate based on a notional amount. If the notional amount of the swap amortizes so that it equals the principal amount of the transferred financial asset outstanding at any point in time, the swap would generally result in the entity retaining substantial prepayment risk, in which case the entity either continues to recognize all of the transferred asset or continues to recognize the transferred asset to the extent of its

continuing involvement. Conversely, if the amortization of the notional amount of the swap is not linked to the principal amount outstanding of the transferred asset, such a swap would not result in the entity retaining prepayment risk on the asset. Hence, it would not preclude derecognition of the transferred asset provided the payments on the swap are not conditional on interest payments being made on the transferred asset and the swap does not result in the entity retaining any other significant risks and rewards of ownership on the transferred asset.

AG67. This paragraph illustrates the application of the continuing involvement approach when the entity's continuing involvement is in a part of a financial asset.

Assume an entity has a portfolio of prepayable loans whose coupon and effective interest rate is 10 percent and whose principal amount and amortized cost is CU10,000. It enters into a transaction in which, in return for a payment of CU9,115, the transferee obtains the right to CU9,000 of any collections of principal plus interest thereon at 9.5 percent. The entity retains rights to CU1,000 of any collections of principal plus interest thereon at 10 percent, plus the excess spread of 0.5 percent on the remaining CU9,000 of principal. Collections from prepayments are allocated between the entity and the transferee proportionately in the ratio of 1:9, but any defaults are deducted from the entity's interest of CU1,000 until that interest is exhausted. The fair value of the loans at the date of the transaction is CU10,100 and the estimated fair value of the excess spread of 0.5 percent is CU40.

The entity determines that it has transferred some significant risks and rewards of ownership (e.g., significant prepayment risk) but has also retained some significant risks and rewards of ownership (because of its subordinated retained interest) and has retained control. It therefore applies the continuing involvement approach.

To apply this Standard, the entity analyses the transaction as (a) a retention of a fully proportionate retained interest of CU1,000, plus (b) the subordination of that retained interest to provide credit enhancement to the transferee for credit losses.

The entity calculates that CU9,090 (90 percent × CU10,100) of the consideration received of CU9,115 represents the consideration for a fully proportionate 90 percent share. The remainder of the consideration received (CU25) represents consideration received for subordinating its retained interest to provide credit enhancement to the transferee for credit losses. In addition, the excess spread of 0.5 percent represents consideration received for the credit enhancement. Accordingly, the total consideration received for the credit enhancement is CU65 (CU25 + CU40).

The entity calculates the gain or loss on the sale of the 90 percent share of cash flows. Assuming that separate fair values of the 90 percent part transferred and the 10 percent part retained are not available at the date of the transfer, the entity allocates the carrying amount of the asset in accordance with paragraph 30 as follows:

	<i>Estimated fair value</i>	<i>Percentage</i>	<i>Allocated carrying amount</i>
Portion transferred	9,090	90%	9,000
Portion retained	1,010	10%	1,000
Total	10,100		10,000

The entity computes its gain or loss on the sale of the 90 percent share of the cash flows by deducting the allocated carrying amount of the portion transferred from the consideration received, i.e., CU90 (CU9,090 – CU9,000). The carrying amount of the portion retained by the entity is CU1,000.

In addition, the entity recognizes the continuing involvement that results from the subordination of its retained interest for credit losses. Accordingly, it recognizes an asset of CU1,000 (the maximum amount of the cash flows it would not receive under the subordination), and an associated liability of CU1,065 (which is the maximum amount of the cash flows it would not receive under the subordination, i.e., CU1,000 plus the fair value of the subordination of CU65). The entity uses all of the above information to account for the transaction as follows:

	<i>Debit</i>	<i>Credit</i>
Original asset	–	9,000
Asset recognized for subordination or the residual interest	1,000	–
Asset for the consideration received in the form of excess spread	40	–
Surplus or deficit (gain on transfer)	–	90
Liability	–	1,065
Cash received	9,115	–
Total	10,155	10,155

Immediately following the transaction, the carrying amount of the asset is CU2,040 comprising CU1,000, representing the allocated cost of the portion retained, and CU1,040, representing the entity's additional continuing involvement from the subordination of its retained interest for credit losses (which includes the excess spread of CU40).

In subsequent periods, the entity recognizes the consideration received for the credit enhancement (CU65) on a time proportion basis, accrues interest on the recognized asset using the effective interest method and recognizes any credit impairment on the recognized assets. As an example of the latter, assume that in the following year there is a credit impairment loss on the underlying loans of CU300. The entity reduces its recognized asset by CU600 (CU300 relating to its retained interest and CU300 relating to the additional continuing involvement that arises from the subordination of its retained interest for credit losses), and reduces its recognized liability by CU300. The net result is a charge to surplus or deficit for credit impairment of CU300.

Regular Way Purchase or Sale of a Financial Asset (paragraph 40)

- AG68. A regular way purchase or sale of financial assets is recognized using either trade date accounting or settlement date accounting as described in paragraphs AG70 and AG71. The method used is applied consistently for all purchases and sales of financial assets that belong to the same category of financial assets defined in paragraph 10. For this purpose assets that are held for trading form a separate category from assets designated at fair value through surplus or deficit.

- AG69. A contract that requires or permits net settlement of the change in the value of the contract is not a regular way contract. Instead, such a contract is accounted for as a derivative in the period between the trade date and the settlement date.
- AG70. The trade date is the date that an entity commits itself to purchase or sell an asset. Trade date accounting refers to (a) the recognition of an asset to be received and the liability to pay for it on the trade date, and (b) derecognition of an asset that is sold, recognition of any gain or loss on disposal and the recognition of a receivable from the buyer for payment on the trade date. Generally, interest does not start to accrue on the asset and corresponding liability until the settlement date when title passes.
- AG71. The settlement date is the date that an asset is delivered to or by an entity. Settlement date accounting refers to (a) the recognition of an asset on the day it is received by the entity, and (b) the derecognition of an asset and recognition of any gain or loss on disposal on the day that it is delivered by the entity. When settlement date accounting is applied an entity accounts for any change in the fair value of the asset to be received during the period between the trade date and the settlement date in the same way as it accounts for the acquired asset. In other words, the change in value is not recognized for assets carried at cost or amortized cost; it is recognized in surplus or deficit for assets classified as financial assets at fair value through surplus or deficit; and it is recognized in net assets/equity for assets classified as available for sale.

Derecognition of a Financial Liability (paragraphs 41–44)

- AG72. A financial liability (or part of it) is extinguished when the debtor either:
- (a) Discharges the liability (or part of it) by paying the creditor, normally with cash, other financial assets, goods or services; or
 - (b) Is legally released from primary responsibility for the liability (or part of it) either by process of law or by the creditor. (If the debtor has given a guarantee this condition may still be met).
- AG73. If an issuer of a debt instrument repurchases that instrument, the debt is extinguished even if the issuer is a market maker in that instrument or intends to resell it in the near term.
- AG74. Payment to a third party, including a trust (sometimes called “in-substance defeasance”), does not, by itself, relieve the debtor of its primary obligation to the creditor, in the absence of legal release.
- AG75. If a debtor pays a third party to assume an obligation and notifies its creditor that the third party has assumed its debt obligation, the debtor does not derecognize the debt obligation unless the condition in paragraph AG72(b) is met. If the debtor pays a third party to assume an obligation

and obtains a legal release from its creditor, the debtor has extinguished the debt. However, if the debtor agrees to make payments on the debt to the third party or direct to its original creditor, the debtor recognizes a new debt obligation to the third party.

- AG76. If a third party assumes an obligation of an entity, and the entity provides either no or only nominal consideration to that third party in return, an entity applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of IPSAS 23.
- AG77. Lenders will sometimes waive their right to collect debt owed by a public sector entity, for example, a national government may cancel a loan owed by a local government. This waiver of debt would constitute a legal release of the debt owing by the borrower to the lender. Where an entity's obligations have been waived as part of a non-exchange transaction it applies the derecognition requirements of this Standard as well as paragraphs 84 to 87 of IPSAS 23.
- AG78. Although legal release, whether judicially or by the creditor, results in derecognition of a liability, the entity may recognize a new liability if the derecognition criteria in paragraphs 17–39 are not met for the financial assets transferred. If those criteria are not met, the transferred assets are not derecognized, and the entity recognizes a new liability relating to the transferred assets.
- AG79. For the purpose of paragraph 42, the terms are substantially different if the discounted present value of the cash flows under the new terms, including any fees paid net of any fees received and discounted using the original effective interest rate, is at least 10 percent different from the discounted present value of the remaining cash flows of the original financial liability. If an exchange of debt instruments or modification of terms is accounted for as an extinguishment, any costs or fees incurred are recognized as part of the gain or loss on the extinguishment. If the exchange or modification is not accounted for as an extinguishment, any costs or fees incurred adjust the carrying amount of the liability and are amortized over the remaining term of the modified liability.
- AG80. In some cases, a creditor releases a debtor from its present obligation to make payments, but the debtor assumes a guarantee obligation to pay if the party assuming primary responsibility defaults. In this circumstance the debtor:
- (a) Recognizes a new financial liability based on the fair value of its obligation for the guarantee; and
 - (b) Recognizes a gain or loss based on the difference between (i) any proceeds paid and (ii) the carrying amount of the original financial liability less the fair value of the new financial liability.

Measurement (paragraphs 45–86)*Non-Exchange Revenue Transactions*

AG81. The initial recognition and measurement of assets and liabilities resulting from non-exchange revenue transactions is dealt with in IPSAS 23. Assets resulting from non-exchange revenue transactions can arise out of both contractual and non-contractual arrangements (see IPSAS 28 paragraphs AG20 and AG21). Where these assets arise out of contractual arrangements and otherwise meet the definition of a financial instrument, they are:

- (a) Initially recognized in accordance with IPSAS 23;
- (b) Initially measured:
 - (i) At fair value using the principles in IPSAS 23; and
 - (ii) Taking account of transaction costs that are directly attributable to the acquisition of the financial asset in accordance with paragraph 45 of this Standard, where the asset is subsequently measured other than at fair value through surplus or deficit.

(See paragraphs IE46 to IE50 accompanying this Standard).

Initial Measurement of Financial Assets and Financial Liabilities (paragraph 45)

AG82. The fair value of a financial instrument on initial recognition is normally the transaction price (i.e., the fair value of the consideration given or received, see also paragraph AG108). However, if part of the consideration given or received is for something other than the financial instrument, the fair value of the financial instrument is estimated, using a valuation technique (see paragraphs AG106–AG112). For example, the fair value of a long-term loan or receivable that carries no interest can be estimated as the present value of all future cash receipts discounted using the prevailing market rate(s) of interest for a similar instrument (similar as to currency, term, type of interest rate and other factors) with a similar credit rating. Any additional amount lent is an expense or a reduction of revenue unless it qualifies for recognition as some other type of asset.

AG83. If an entity originates a loan that bears an off-market interest rate (e.g., 5 percent when the market rate for similar loans is 8 percent), and receives an up-front fee as compensation, the entity recognizes the loan at its fair value, i.e., net of the fee it receives. The entity accretes the discount to surplus or deficit using the effective interest rate method.

Concessionary Loans

- AG84. Concessionary loans are granted to or received by an entity at below market terms. Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education and housing loans granted to low income families. Entities may receive concessionary loans, for example, from development agencies and other government entities.
- AG85. The granting or receiving of a concessionary loan is distinguished from the waiver of debt owing to or by an entity. This distinction is important because it affects whether the below market conditions are considered in the initial recognition or measurement of the loan rather than as part of the subsequent measurement or derecognition.
- AG86. The intention of a concessionary loan at the outset is to provide or receive resources at below market terms. A waiver of debt results from loans initially granted or received at market related terms where the intention of either party to the loan has changed subsequent to its initial issue or receipt. For example, a government may lend money to a not-for-profit entity with the intention that the loan be repaid in full on market terms. However, the government may subsequently write-off part of the loan. This is not a concessionary loan as the intention of the loan at the outset was to provide credit to an entity at market related rates. An entity would treat the subsequent write-off of the loan as a waiver of debt and apply the derecognition requirements of IPSAS 29.
- AG87. As concessionary loans are granted or received at below market terms, the transaction price on initial recognition of the loan may not be its fair value. At initial recognition, an entity therefore analyzes the substance of the loan granted or received into its component parts, and accounts for those components using the principles in paragraphs AG88 and AG89 below.
- AG88. An entity firstly assesses whether the substance of the concessionary loan is in fact a loan, a grant, a contribution from owners or a combination thereof, by applying the principles in IPSAS 28 and paragraphs 42–58 of IPSAS 23. If an entity has determined that the transaction, or part of the transaction, is a loan, it assesses whether the transaction price represents the fair value of the loan on initial recognition. An entity determines the fair value of the loan by using the principles in AG101–AG115. Where an entity cannot determine fair value by reference to an active market, it uses a valuation technique. Fair value using a valuation technique could be determined by discounting all future cash receipts using a market related rate of interest for a similar loan (see AG82).
- AG89. Any difference between the fair value of the loan and the transaction price (the loan proceeds) is treated as follows:

- (a) Where the loan is received by an entity, the difference is accounted for in accordance with IPSAS 23.
- (b) Where the loan is granted by an entity, the difference is treated as an expense in surplus or deficit at initial recognition, except where the loan is a transaction with owners, in their capacity as owners. Where the loan is a transaction with owners in their capacity as owners, for example, where a controlling entity provides a concessionary loan to a controlled entity, the difference may represent a capital contribution, i.e., an investment in an entity, rather than an expense.

Illustrative Examples are provided in paragraph IG54 of IPSAS 23 as well as paragraphs IE40 to IE41 accompanying this Standard.

- AG90. After initial recognition, an entity subsequently measures concessionary loans using the categories of financial instruments defined in paragraph 10.

Non-Exchange Revenue Transactions

- AG91. [Deleted]

Valuing Financial Guarantees Issued Through a Non-Exchange Transaction

- AG92. Only contractual financial guarantees (or guarantees that are in substance, contractual) are within the scope of this Standard (See AG3 and AG4 of IPSAS 28). Non-contractual guarantees are not within the scope of this Standard as they do not meet the definition of a financial instrument. This Standard prescribes recognition and measurement requirements only for the issuer of financial guarantee contracts.
- AG93. In paragraph 10 a “financial guarantee contract” is defined as “a contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.” Under the requirements of this Standard, financial guarantee contracts, like other financial assets and financial liabilities, are required to be initially recognized at fair value. Paragraphs 50–52 of this Standard provide commentary and guidance on determining fair value and this is complemented by Application Guidance in paragraphs AG101–AG115. Subsequent measurement for financial guarantee contracts is at the higher of the amount determined in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognized less, when appropriate, cumulative amortization in accordance with IPSAS 9, *Revenue from Exchange Transactions*.
- AG94. In the public sector, guarantees are frequently provided by way of non-exchange transactions, i.e., at no or nominal consideration. This type of

guarantee is provided generally to further the entity's economic and social objectives. Such purposes include supporting infrastructure projects, supporting corporate entities at times of economic distress, guaranteeing the bond issues of entities in other tiers of governments and the loans of employees to finance motor vehicles that are to be used for performance of their duties as employees. Where there is consideration for a financial guarantee, an entity should determine whether that consideration arises from an exchange transaction and whether the consideration represents a fair value. If the consideration does represent a fair value, entities should recognize the financial guarantee at the amount of the consideration. Subsequent measurement should be at the higher of the amount determined in accordance with IPSAS 19 and the amount initially recognized, less, when appropriate, cumulative amortization recognized in accordance with IPSAS 9. Where the entity concludes that the consideration is not a fair value, an entity determines the carrying value at initial recognition in the same way as if no consideration had been paid.

- AG95. At initial recognition, where no fee is charged or where the consideration is not fair value, an entity firstly considers whether there are quoted prices available in an active market for financial guarantee contracts directly equivalent to that entered into. Evidence of an active market includes recent arm's length market transactions between knowledgeable willing parties, and reference to the current fair value of another financial guarantee contract that is substantially the same as that provided at nil or nominal consideration by the issuer. The fact that a financial guarantee contract has been entered into at no consideration by the debtor to the issuer is not, of itself, conclusive evidence of the absence of an active market. Guarantees may be available from commercial issuers, but a public sector entity may agree to enter into a financial guarantee contract for a number of non-commercial reasons. For example, if a debtor is unable to afford a commercial fee, and initiation of a project in fulfillment of one of the entity's social or policy objectives would be put at risk unless a financial guarantee contract is issued, it may approach a public sector entity or government to issue a financial guarantee contract
- AG96. Where there is no active market for a directly equivalent guarantee contract; the entity considers whether a valuation technique other than observation of an active market is available and provides a reliable measure of fair value. Such a valuation technique may rely on mathematical models which consider financial risk. For example, National Government W guarantees a bond issue of Municipality X. As Municipality X has a government guarantee backing its bond issue, its bonds have a lower coupon than if they were not secured by a government guarantee. This is because the guarantee lowers the risk profile of the bonds for investors. The guarantee fee could be determined by using the credit spread between what the coupon rate would have been had the issue

not been backed by a government guarantee and the rate with the guarantee in place. Where a fair value is obtainable either by observation of an active market or through another valuation technique, the entity recognizes the financial guarantee at that fair value in the statement of financial position and recognizes an expense of an equivalent amount in the statement of financial performance. When using a valuation technique that is not based on observation of an active market an entity needs to satisfy itself that the output of any model is reliable and understandable.

- AG97. If no reliable measure of fair value can be determined, either by direct observation of an active market or through another valuation technique, an entity is required to apply the principles of IPSAS 19 to the financial guarantee contract at initial recognition. The entity assesses whether a present obligation has arisen as a result of a past event related to a financial guarantee contract whether it is probable that such a present obligation will result in a cash outflow in accordance with the terms of the contract and whether a reliable estimate can be made of the outflow. It is possible that a present obligation related to a financial guarantee contract will arise at initial recognition where, for example, an entity enters into a financial guarantee contract to guarantee loans to a large number of small enterprises and, based on past experience, is aware that a proportion of these enterprises will default.

Subsequent Measurement of Financial Assets (paragraphs 47 and 48)

- AG98. If a financial instrument that was previously recognized as a financial asset is measured at fair value and its fair value falls below zero, it is a financial liability measured in accordance with paragraph 49.
- AG99. The following example illustrates the accounting for transaction costs on the initial and subsequent measurement of an available-for-sale financial asset. An asset is acquired for CU100 plus a purchase commission of CU2. Initially, the asset is recognized at CU102. The end of the reporting period occurs one day later, when the quoted market price of the asset is CU100. If the asset were sold, a commission of CU3 would be paid. On that date, the asset is measured at CU100 (without regard to the possible commission on sale) and a loss of CU2 is recognized in net assets/equity. If the available-for-sale financial asset has fixed or determinable payments, the transaction costs are amortized to surplus or deficit using the effective interest method. If the available-for-sale financial asset does not have fixed or determinable payments, the transaction costs are recognized in surplus or deficit when the asset is derecognized or becomes impaired.
- AG100. Instruments that are classified as loans and receivables are measured at amortized cost without regard to the entity's intention to hold them to maturity.

Fair Value Measurement Considerations (paragraphs 50–52)

- AG101. Underlying the definition of fair value is a presumption that an entity is a going concern without any intention or need to liquidate, to curtail materially the scale of its operations or to undertake a transaction on adverse terms. Fair value is not, therefore, the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale. However, fair value reflects the credit quality of the instrument.
- AG102. This Standard uses the terms “bid price” and “asking price” (sometimes referred to as “current offer price”) in the context of quoted market prices, and the term “the bid-ask spread” to include only transaction costs. Other adjustments to arrive at fair value (e.g., for counterparty credit risk) are not included in the term “bid-ask spread.”

Active Market: Quoted Price

- AG103. A financial instrument is regarded as quoted in an active market if quoted prices are readily and regularly available from an exchange, dealer, broker, industry group, pricing service or regulatory agency, and those prices represent actual and regularly occurring market transactions on an arm’s length basis. Fair value is defined in terms of a price agreed by a willing buyer and a willing seller in an arm’s length transaction. The objective of determining fair value for a financial instrument that is traded in an active market is to arrive at the price at which a transaction would occur at the end of the reporting period in that instrument (i.e., without modifying or repackaging the instrument) in the most advantageous active market to which the entity has immediate access. However, the entity adjusts the price in the more advantageous market to reflect any differences in counterparty credit risk between instruments traded in that market and the one being valued. The existence of published price quotations in an active market is the best evidence of fair value and when they exist they are used to measure the financial asset or financial liability.
- AG104. The appropriate quoted market price for an asset held or liability to be issued is usually the current bid price and, for an asset to be acquired or liability held, the asking price. When an entity has assets and liabilities with offsetting market risks, it may use mid-market prices as a basis for establishing fair values for the offsetting risk positions and apply the bid or asking price to the net open position as appropriate. When current bid and asking prices are unavailable, the price of the most recent transaction provides evidence of the current fair value as long as there has not been a significant change in economic circumstances since the time of the transaction. If conditions have changed since the time of the transaction (e.g., a change in the risk-free interest rate following the most recent price quote for a government bond), the fair value reflects the change in conditions by reference to current prices or rates for similar financial

instruments, as appropriate. Similarly, if the entity can demonstrate that the last transaction price is not fair value (e.g., because it reflected the amount that an entity would receive or pay in a forced transaction, involuntary liquidation or distress sale), that price is adjusted. The fair value of a portfolio of financial instruments is the product of the number of units of the instrument and its quoted market price. If a published price quotation in an active market does not exist for a financial instrument in its entirety, but active markets exist for its component parts, fair value is determined on the basis of the relevant market prices for the component parts.

- AG105. If a rate (rather than a price) is quoted in an active market, the entity uses that market-quoted rate as an input into a valuation technique to determine fair value. If the market-quoted rate does not include credit risk or other factors that market participants would include in valuing the instrument, the entity adjusts for those factors.

No Active Market: Valuation Technique

- AG106. If the market for a financial instrument is not active, an entity establishes fair value by using a valuation technique. Valuation techniques include using recent arm's length market transactions between knowledgeable, willing parties, if available, reference to the current fair value of another instrument that is substantially the same, discounted cash flow analysis and option pricing models. If there is a valuation technique commonly used by market participants to price the instrument and that technique has been demonstrated to provide reliable estimates of prices obtained in actual market transactions, the entity uses that technique.
- AG107. The objective of using a valuation technique is to establish what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal operating considerations. Fair value is estimated on the basis of the results of a valuation technique that makes maximum use of market inputs, and relies as little as possible on entity-specific inputs. A valuation technique would be expected to arrive at a realistic estimate of the fair value if (a) it reasonably reflects how the market could be expected to price the instrument and (b) the inputs to the valuation technique reasonably represent market expectations and measures of the risk-return factors inherent in the financial instrument.
- AG108. Therefore, a valuation technique (a) incorporates all factors that market participants would consider in setting a price and (b) is consistent with accepted economic methodologies for pricing financial instruments. Periodically, an entity calibrates the valuation technique and tests it for validity using prices from any observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on any available observable market data. An entity obtains market data

consistently in the same market where the instrument was originated or purchased. The best evidence of the fair value of a financial instrument at initial recognition, in an exchange transaction, is the transaction price (i.e., the fair value of the consideration given or received) unless the fair value of that instrument is evidenced by comparison with other observable current market transactions in the same instrument (i.e., without modification or repackaging) or based on a valuation technique whose variables include only data from observable markets.

- AG109. The subsequent measurement of the financial asset or financial liability and the subsequent recognition of gains and losses shall be consistent with the requirements of this Standard. The application of paragraph AG108 may result in no gain or loss being recognized on the initial recognition of a financial asset or financial liability. In such a case, IPSAS 29 requires that a gain or loss shall be recognized after initial recognition only to the extent that it arises from a change in a factor (including time) that market participants would consider in setting a price.
- AG110. The initial acquisition or origination of a financial asset or incurrence of a financial liability is a market transaction that provides a foundation for estimating the fair value of the financial instrument. In particular, if the financial instrument is a debt instrument (such as a loan), its fair value can be determined by reference to the market conditions that existed at its acquisition or origination date and current market conditions or interest rates currently charged by the entity or by others for similar debt instruments (i.e., similar remaining maturity, cash flow pattern, currency, credit risk, collateral and interest basis). Alternatively, provided there is no change in the credit risk of the debtor and applicable credit spreads after the origination of the debt instrument, an estimate of the current market interest rate may be derived by using a benchmark interest rate reflecting a better credit quality than the underlying debt instrument, holding the credit spread constant, and adjusting for the change in the benchmark interest rate from the origination date. If conditions have changed since the most recent market transaction, the corresponding change in the fair value of the financial instrument being valued is determined by reference to current prices or rates for similar financial instruments, adjusted as appropriate, for any differences from the instrument being valued.
- AG111. The same information may not be available at each measurement date. For example, at the date that an entity makes a loan or acquires a debt instrument that is not actively traded, the entity has a transaction price that is also a market price. However, no new transaction information may be available at the next measurement date and, although the entity can determine the general level of market interest rates, it may not know what level of credit or other risk market participants would consider in pricing

the instrument on that date. An entity may not have information from recent transactions to determine the appropriate credit spread over the basic interest rate to use in determining a discount rate for a present value computation. It would be reasonable to assume, in the absence of evidence to the contrary, that no changes have taken place in the spread that existed at the date the loan was made. However, the entity would be expected to make reasonable efforts to determine whether there is evidence that there has been a change in such factors. When evidence of a change exists, the entity would consider the effects of the change in determining the fair value of the financial instrument.

- AG112. In applying discounted cash flow analysis, an entity uses one or more discount rates equal to the prevailing rates of return for financial instruments having substantially the same terms and characteristics, including the credit quality of the instrument, the remaining term over which the contractual interest rate is fixed, the remaining term to repayment of the principal and the currency in which payments are to be made. Short-term receivables and payables with no stated interest rate may be measured at the original invoice amount if the effect of discounting is immaterial.

No Active Market: Equity Instruments

- AG113. The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 48(c) and 49) is reliably measurable if (a) the variability in the range of reasonable fair value estimates is not significant for that instrument or (b) the probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.
- AG114. There are many situations in which the variability in the range of reasonable fair value estimates of investments in equity instruments that do not have a quoted market price and derivatives that are linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 48(c) and 49) is likely not to be significant. Normally it is possible to estimate the fair value of a financial asset that an entity has acquired from an outside party. However, if the range of reasonable fair value estimates is significant and the probabilities of the various estimates cannot be reasonably assessed, an entity is precluded from measuring the instrument at fair value.

Inputs to Valuation Techniques

- AG115. An appropriate technique for estimating the fair value of a particular financial instrument would incorporate observable market data about the market conditions and other factors that are likely to affect the

instrument's fair value. The fair value of a financial instrument will be based on one or more of the following factors (and perhaps others).

- (a) The time value of money (i.e., interest at the basic or risk-free rate). Basic interest rates can usually be derived from observable government bond prices and are often quoted in financial publications. These rates typically vary with the expected dates of the projected cash flows along a yield curve of interest rates for different time horizons. For practical reasons, an entity may use a well-accepted and readily observable general market rate, such as a swap rate, as the benchmark rate. (If the rate used is not the risk-free interest rate, the credit risk adjustment appropriate to the particular financial instrument is determined on the basis of its credit risk in relation to the credit risk in this benchmark rate). In some countries, the central government's bonds may carry a significant credit risk and may not provide a stable benchmark basic interest rate for instruments denominated in that currency. Some entities in these countries may have a better credit standing and a lower borrowing rate than the central government. In such a case, basic interest rates may be more appropriately determined by reference to interest rates for the highest rated corporate bonds issued in the currency of that jurisdiction.
- (b) Credit risk. The effect on fair value of credit risk (i.e., the premium over the basic interest rate for credit risk) may be derived from observable market prices for traded instruments of different credit quality or from observable interest rates charged by lenders for loans of various credit ratings.
- (c) Foreign currency exchange prices. Active currency exchange markets exist for most major currencies, and prices are quoted daily in financial publications.
- (d) Commodity prices. There are observable market prices for many commodities.
- (e) Equity prices. Prices (and indexes of prices) of traded equity instruments are readily observable in some markets. Present value based techniques may be used to estimate the current market price of equity instruments for which there are no observable prices.
- (f) Volatility (i.e., magnitude of future changes in price of the financial instrument or other item). Measures of the volatility of actively traded items can normally be reasonably estimated on the basis of historical market data or by using volatilities implied in current market prices.

- (g) Prepayment risk and surrender risk. Expected prepayment patterns for financial assets and expected surrender patterns for financial liabilities can be estimated on the basis of historical data. (The fair value of a financial liability that can be surrendered by the counterparty cannot be less than the present value of the surrender amount – see paragraph 52).
- (h) Servicing costs for a financial asset or a financial liability. Costs of servicing can be estimated using comparisons with current fees charged by other market participants. If the costs of servicing a financial asset or financial liability are significant and other market participants would face comparable costs, the issuer would consider them in determining the fair value of that financial asset or financial liability. It is likely that the fair value at inception of a contractual right to future fees equals the origination costs paid for them, unless future fees and related costs are out of line with market comparables.

Gains and Losses (paragraphs 64–66)

AG116. An entity applies IPSAS 4 to financial assets and financial liabilities that are monetary items in accordance with IPSAS 4 and denominated in a foreign currency. Under IPSAS 4, any foreign exchange gains and losses on monetary assets and monetary liabilities are recognized in surplus or deficit. An exception is a monetary item that is designated as a hedging instrument in either a cash flow hedge (see paragraphs 106–112) or a hedge of a net investment (see paragraph 113). For the purpose of recognizing foreign exchange gains and losses under IPSAS 4, a monetary available-for-sale financial asset is treated as if it were carried at amortized cost in the foreign currency. Accordingly, for such a financial asset, exchange differences resulting from changes in amortized cost are recognized in surplus or deficit and other changes in carrying amount are recognized in accordance with paragraph 64(b). For available-for-sale financial assets that are not monetary items under IPSAS 4 (e.g., equity instruments), the gain or loss that is recognized directly in net assets/equity under paragraph 64(b) includes any related foreign exchange component. If there is a hedging relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in the foreign currency component of those financial instruments are recognized in surplus or deficit.

Impairment and Uncollectibility of Financial Assets (paragraphs 67–79)

Financial Assets Carried at Amortized Cost (paragraphs 72–74)

AG117. Impairment of a financial asset carried at amortized cost is measured using the financial instrument's original effective interest rate because

discounting at the current market rate of interest would, in effect, impose fair value measurement on financial assets that are otherwise measured at amortized cost. If the terms of a loan, receivable or held-to-maturity investment are renegotiated or otherwise modified because of financial difficulties of the borrower or issuer, impairment is measured using the original effective interest rate before the modification of terms. Cash flows relating to short-term receivables are not discounted if the effect of discounting is immaterial. If a loan, receivable or held-to-maturity investment has a variable interest rate, the discount rate for measuring any impairment loss under paragraph 72 is the current effective interest rate(s) determined under the contract. As a practical expedient, a creditor may measure impairment of a financial asset carried at amortized cost on the basis of an instrument's fair value using an observable market price. The calculation of the present value of the estimated future cash flows of a collateralized financial asset reflects the cash flows that may result from foreclosure less costs for obtaining and selling the collateral, whether or not foreclosure is probable.

- AG118. The process for estimating impairment considers all credit exposures, not only those of low credit quality. For example, if an entity uses an internal credit grading system it considers all credit grades, not only those reflecting a severe credit deterioration.
- AG119. The process for estimating the amount of an impairment loss may result either in a single amount or in a range of possible amounts. In the latter case, the entity recognizes an impairment loss equal to the best estimate within the range taking into account all relevant information available before the financial statements are issued about conditions existing at the end of the reporting period (paragraph 47 of IPSAS 19 contains guidance on how to determine the best estimate in a range of possible outcomes).
- AG120. For the purpose of a collective evaluation of impairment, financial assets are grouped on the basis of similar credit risk characteristics that are indicative of the debtors' ability to pay all amounts due according to the contractual terms (e.g., on the basis of a credit risk evaluation or grading process that considers asset type, industry, geographical location, collateral type, past-due status and other relevant factors.) The characteristics chosen are relevant to the estimation of future cash flows for groups of such assets by being indicative of the debtors' ability to pay all amounts due according to the contractual terms of the assets being evaluated. However, loss probabilities and other loss statistics differ at a group level between (a) assets that have been individually evaluated for impairment and found not to be impaired and (b) assets that have not been individually evaluated for impairment, with the result that a different amount of impairment may be required. If an entity does not have a group

of assets with similar risk characteristics, it does not make the additional assessment.

- AG121. Impairment losses recognized on a group basis represent an interim step pending the identification of impairment losses on individual assets in the group of financial assets that are collectively assessed for impairment. As soon as information is available that specifically identifies losses on individually impaired assets in a group, those assets are removed from the group.
- AG122. Future cash flows in a group of financial assets that are collectively evaluated for impairment are estimated on the basis of historical loss experience for assets with credit risk characteristics similar to those in the group. Entities that have no entity-specific loss experience or insufficient experience, use peer group experience for comparable groups of financial assets. Historical loss experience is adjusted on the basis of current observable data to reflect the effects of current conditions that did not affect the period on which the historical loss experience is based and to remove the effects of conditions in the historical period that do not exist currently. Estimates of changes in future cash flows reflect and are directionally consistent with changes in related observable data from period to period (such as changes in unemployment rates, property prices, commodity prices, payment status or other factors that are indicative of incurred losses in the group and their magnitude). The methodology and assumptions used for estimating future cash flows are reviewed regularly to reduce any differences between loss estimates and actual loss experience.
- AG123. As an example of applying paragraph AG122, an entity may determine, on the basis of historical experience, that one of the main causes of default on loans is the death of the borrower. The entity may observe that the death rate is unchanged from one year to the next. Nevertheless, some of the borrowers in the entity's group of loans may have died in that year, indicating that an impairment loss has occurred on those loans, even if, at the year-end, the entity is not yet aware which specific borrowers have died. It would be appropriate for an impairment loss to be recognized for these "incurred but not reported" losses. However, it would not be appropriate to recognize an impairment loss for deaths that are expected to occur in a future period, because the necessary loss event (the death of the borrower) has not yet occurred.
- AG124. When using historical loss rates in estimating future cash flows, it is important that information about historical loss rates is applied to groups that are defined in a manner consistent with the groups for which the historical loss rates were observed. Therefore, the method used should enable each group to be associated with information about past loss

experience in groups of assets with similar credit risk characteristics and relevant observable data that reflect current conditions.

- AG125. Formula-based approaches or statistical methods may be used to determine impairment losses in a group of financial assets (e.g., for smaller balance loans) as long as they are consistent with the requirements in paragraphs 72–74 and AG120–AG124. Any model used would incorporate the effect of the time value of money, consider the cash flows for all of the remaining life of an asset (not only the next year), consider the age of the loans within the portfolio and not give rise to an impairment loss on initial recognition of a financial asset.

Interest Revenue after Impairment Recognition

- AG126. Once a financial asset or a group of similar financial assets has been written down as a result of an impairment loss, interest revenue is thereafter recognized using the rate of interest used to discount the future cash flows for the purpose of measuring the impairment loss.

Hedging (paragraphs 80–113)

Hedging Instruments (paragraphs 81–86)

Qualifying Instruments (paragraphs 81 and 82)

- AG127. The potential loss on an option that an entity writes could be significantly greater than the potential gain in value of a related hedged item. In other words, a written option is not effective in reducing the surplus or deficit exposure of a hedged item. Therefore, a written option does not qualify as a hedging instrument unless it is designated as an offset to a purchased option, including one that is embedded in another financial instrument (e.g., a written call option used to hedge a callable liability). In contrast, a purchased option has potential gains equal to or greater than losses and therefore has the potential to reduce surplus or deficit exposure from changes in fair values or cash flows. Accordingly, it can qualify as a hedging instrument.
- AG128. A held-to-maturity investment carried at amortized cost may be designated as a hedging instrument in a hedge of foreign currency risk.
- AG129. An investment in an unquoted equity instrument that is not carried at fair value because its fair value cannot be reliably measured or a derivative that is linked to and must be settled by delivery of such an unquoted equity instrument (see paragraphs 48(c) and 49) cannot be designated as a hedging instrument.
- AG130. An entity's own equity instruments are not financial assets or financial liabilities of the entity and therefore cannot be designated as hedging instruments.

*Hedged items (paragraphs 87–94)***Qualifying items (paragraphs 87–89)**

- AG131. A firm commitment to acquire an entity or an integrated set of activities in an entity combination cannot be a hedged item, except for foreign exchange risk, because the other risks being hedged cannot be specifically identified and measured. These other risks are general operational risks.
- AG132. An equity method investment cannot be a hedged item in a fair value hedge because the equity method recognizes in surplus or deficit the investor's share of the associate's surplus or deficit, rather than changes in the investment's fair value. For a similar reason, an investment in a consolidated controlled entity cannot be a hedged item in a fair value hedge because consolidation recognizes in surplus or deficit the controlled entity's surplus or deficit, rather than changes in the investment's fair value. A hedge of a net investment in a foreign operation is different because it is a hedge of the foreign currency exposure, not a fair value hedge of the change in the value of the investment.
- AG133. Paragraph 89 states that in consolidated financial statements the foreign currency risk of a highly probable forecast transaction within the economic entity may qualify as a hedged item in a cash flow hedge, provided the transaction is denominated in a currency other than the functional currency of the entity entering into that transaction and the foreign currency risk will affect consolidated surplus or deficit. For this purpose an entity can be a controlling entity, controlled entity, associate, joint venture or branch. If the foreign currency risk of a forecast transaction within the economic entity does not affect consolidated surplus or deficit, the transaction cannot qualify as a hedged item. This is usually the case for royalty payments, interest payments or management charges between members of the same economic entity unless there is a related external transaction. However, when the foreign currency risk of a forecast transaction within the economic entity will affect consolidated surplus or deficit, the transaction can qualify as a hedged item. An example is forecast sales or purchases of inventories between members of the same economic entity if there is an onward sale of the inventory to a party external to the economic entity. Similarly, a forecast sale of property, plant and equipment within the economic entity from the entity that constructed it to the entity that will use the property, plant and equipment in its operations may affect consolidated surplus or deficit. This could occur, for example, because the plant and equipment will be depreciated by the purchasing entity and the amount initially recognized for the plant and equipment may change if the forecast transaction within the economic entity is denominated in a currency other than the functional currency of the purchasing entity.

- AG134. If a hedge of a forecast transaction within the economic entity qualifies for hedge accounting, any gain or loss that is recognized directly in net assets/equity in accordance with paragraph 106(a) shall be reclassified into surplus or deficit in the same period or periods during which the foreign currency risk of the hedged transaction affects consolidated surplus or deficit.
- AG135. An entity can designate all changes in the cash flows or fair value of a hedged item in a hedging relationship. An entity can also designate only changes in the cash flows or fair value of a hedged item above or below a specified price or other variable (a one-sided risk). The intrinsic value of a purchased option hedging instrument (assuming that it has the same principal terms as the designated risk), but not its time value, reflects a one-sided risk in a hedged item. For example, an entity can designate the variability of future cash flow outcomes resulting from a price increase of a forecast commodity purchase. In such a situation, only cash flow losses that result from an increase in the price above the specified level are designated. The hedged risk does not include the time value of a purchased option because the time value is not a component of the forecast transaction that affects surplus or deficit (paragraph 96(b)).

Designation of Financial Items as Hedged Items (paragraphs 90 and 91)

- AG136. If a portion of the cash flows of a financial asset or financial liability is designated as the hedged item, that designated portion must be less than the total cash flows of the asset or liability. For example, in the case of a liability whose effective interest rate is below a market related interest rate, an entity cannot designate (a) a portion of the liability equal to the principal amount plus interest at a market related rate and (b) a negative residual portion. However, the entity may designate all of the cash flows of the entire financial asset or financial liability as the hedged item and hedge them for only one particular risk (e.g., only for changes that are attributable to changes in the market rate). For example, in the case of a financial liability whose effective interest rate is 100 basis points below the market rate, an entity can designate as the hedged item the entire liability (i.e., principal plus interest at the market rate minus 100 basis points) and hedge the change in the fair value or cash flows of that entire liability that is attributable to changes in the market rate. The entity may also choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge as described in paragraph AG140.
- AG137. In addition, if a fixed rate financial instrument is hedged some time after its origination and interest rates have changed in the meantime, the entity can designate a portion equal to a benchmark rate that is higher than the contractual rate paid on the item. The entity can do so provided that the

benchmark rate is less than the effective interest rate calculated on the assumption that the entity had purchased the instrument on the day it first designates the hedged item. For example, assume an entity originates a fixed rate financial asset of CU100 that has an effective interest rate of 6 percent at a time when the market rate is 4 percent. It begins to hedge that asset some time later when the market rate has increased to 8 percent and the fair value of the asset has decreased to CU90. The entity calculates that if it had purchased the asset on the date it first designates it as the hedged item for its then fair value of CU90, the effective yield would have been 9.5 percent. Because the market rate is less than this effective yield, the entity can designate a portion of the market rate of 8 percent that consists partly of the contractual interest cash flows and partly of the difference between the current fair value (i.e., CU90) and the amount repayable on maturity (i.e., CU100).

AG138. Paragraph 90 permits an entity to designate something other than the entire fair value change or cash flow variability of a financial instrument. For example:

- (a) All of the cash flows of a financial instrument may be designated for cash flow or fair value changes attributable to some (but not all) risks; or
- (b) Some (but not all) of the cash flows of a financial instrument may be designated for cash flow or fair value changes attributable to all or only some risks (i.e., a “portion” of the cash flows of the financial instrument may be designated for changes attributable to all or only some risks).

AG139. To be eligible for hedge accounting, the designated risks and portions must be separately identifiable components of the financial instrument, and changes in the cash flows or fair value of the entire financial instrument arising from changes in the designated risks and portions must be reliably measurable. For example:

- (a) For a fixed rate financial instrument hedged for changes in fair value attributable to changes in a risk-free or benchmark interest rate, the risk-free or benchmark rate is normally regarded as both a separately identifiable component of the financial instrument and reliably measurable.
- (b) Inflation is not separately identifiable and reliably measurable and cannot be designated as a risk or a portion of a financial instrument unless the requirements in (c) are met.

A contractually specified inflation portion of the cash flows of a recognized inflation-linked bond (assuming there is no requirement to account for an embedded derivative separately) is separately identifiable

and reliably measurable as long as other cash flows of the instrument are not affected by the inflation portion.

Designation of Non-Financial Items as Hedged Items (paragraph 92)

- AG140. Changes in the price of an ingredient or component of a non-financial asset or non-financial liability generally do not have a predictable, separately measurable effect on the price of the item that is comparable to the effect of, say, a change in market interest rates on the price of a bond. Thus, a non-financial asset or non-financial liability is a hedged item only in its entirety or for foreign exchange risk. If there is a difference between the terms of the hedging instrument and the hedged item (such as for a hedge of the forecast purchase of Brent Crude oil using a forward contract to purchase Light Sweet Crude oil on otherwise similar terms), the hedging relationship nonetheless can qualify as a hedge relationship provided all the conditions in paragraph 98 are met, including that the hedge is expected to be highly effective. For this purpose, the amount of the hedging instrument may be greater or less than that of the hedged item if this improves the effectiveness of the hedging relationship. For example, a regression analysis could be performed to establish a statistical relationship between the hedged item (e.g., a transaction in Brent Crude oil) and the hedging instrument (e.g., a transaction in Light Sweet Crude oil). If there is a valid statistical relationship between the two variables (i.e., between the unit prices of Brent Crude oil and Light Sweet Crude oil), the slope of the regression line can be used to establish the hedge ratio that will maximize expected effectiveness. For example, if the slope of the regression line is 1.02, a hedge ratio based on 0.98 quantities of hedged items to 1.00 quantities of the hedging instrument maximizes expected effectiveness. However, the hedging relationship may result in ineffectiveness that is recognized in surplus or deficit during the term of the hedging relationship.

Designation of Groups of Items as Hedged Items (paragraphs 93 and 94)

- AG141. A hedge of an overall net position (e.g., the net of all fixed rate assets and fixed rate liabilities with similar maturities), rather than of a specific hedged item, does not qualify for hedge accounting. However, almost the same effect on surplus or deficit of hedge accounting for this type of hedging relationship can be achieved by designating as the hedged item part of the underlying items. For example, if a bank has CU100 of assets and CU90 of liabilities with risks and terms of a similar nature and hedges the net CU10 exposure, it can designate as the hedged item CU10 of those assets. This designation can be used if such assets and liabilities are fixed rate instruments, in which case it is a fair value hedge, or if they are variable rate instruments, in which case it is a cash flow hedge. Similarly,

if an entity has a firm commitment to make a purchase in a foreign currency of CU100 and a firm commitment to make a sale in the foreign currency of CU90, it can hedge the net amount of CU10 by acquiring a derivative and designating it as a hedging instrument associated with CU10 of the firm purchase commitment of CU100.

Hedge Accounting (paragraphs 95–113)

- AG142. An example of a fair value hedge is a hedge of exposure to changes in the fair value of a fixed rate debt instrument as a result of changes in interest rates. Such a hedge could be entered into by the issuer or by the holder.
- AG143. An example of a cash flow hedge is the use of a swap to change floating rate debt to fixed rate debt (i.e., a hedge of a future transaction where the future cash flows being hedged are the future interest payments).
- AG144. A hedge of a firm commitment (e.g., a hedge of the change in fuel price relating to an unrecognized contractual commitment by an electric utility to purchase fuel at a fixed price) is a hedge of an exposure to a change in fair value. Accordingly, such a hedge is a fair value hedge. However, under paragraph 97 a hedge of the foreign currency risk of a firm commitment could alternatively be accounted for as a cash flow hedge.

Assessing Hedge Effectiveness

- AG145. A hedge is regarded as highly effective only if both of the following conditions are met:
- (a) At the inception of the hedge and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated. Such an expectation can be demonstrated in various ways, including a comparison of past changes in the fair value or cash flows of the hedged item that are attributable to the hedged risk with past changes in the fair value or cash flows of the hedging instrument, or by demonstrating a high statistical correlation between the fair value or cash flows of the hedged item and those of the hedging instrument. The entity may choose a hedge ratio of other than one to one in order to improve the effectiveness of the hedge as described in paragraph AG140.
 - (b) The actual results of the hedge are within a range of 80–125 percent. For example, if actual results are such that the loss on the hedging instrument is CU120 and the gain on the cash instrument is CU100, offset can be measured by $120/100$, which is 120 percent, or by $100/120$, which is 83 percent. In this example, assuming the hedge meets the condition in (a), the entity would conclude that the hedge has been highly effective.

- AG146. Effectiveness is assessed, at a minimum, at the time an entity prepares its annual financial statements.
- AG147. This Standard does not specify a single method for assessing hedge effectiveness. The method an entity adopts for assessing hedge effectiveness depends on its risk management strategy. For example, if the entity's risk management strategy is to adjust the amount of the hedging instrument periodically to reflect changes in the hedged position, the entity needs to demonstrate that the hedge is expected to be highly effective only for the period until the amount of the hedging instrument is next adjusted. In some cases, an entity adopts different methods for different types of hedges. An entity's documentation of its hedging strategy includes its procedures for assessing effectiveness. Those procedures state whether the assessment includes all of the gain or loss on a hedging instrument or whether the instrument's time value is excluded.
- AG148. If an entity hedges less than 100 percent of the exposure on an item, such as 85 percent, it shall designate the hedged item as being 85 percent of the exposure and shall measure ineffectiveness based on the change in that designated 85 percent exposure. However, when hedging the designated 85 percent exposure, the entity may use a hedge ratio of other than one to one if that improves the expected effectiveness of the hedge, as explained in paragraph AG140.
- AG149. If the principal terms of the hedging instrument and of the hedged asset, liability, firm commitment or highly probable forecast transaction are the same, the changes in fair value and cash flows attributable to the risk being hedged may be likely to offset each other fully, both when the hedge is entered into and afterwards. For example, an interest rate swap is likely to be an effective hedge if the notional and principal amounts, term, repricing dates, dates of interest and principal receipts and payments, and basis for measuring interest rates are the same for the hedging instrument and the hedged item. In addition, a hedge of a highly probable forecast purchase of a commodity with a forward contract is likely to be highly effective if:
- (a) The forward contract is for the purchase of the same quantity of the same commodity at the same time and location as the hedged forecast purchase;
 - (b) The fair value of the forward contract at inception is zero; and
 - (c) Either the change in the discount or premium on the forward contract is excluded from the assessment of effectiveness and recognized in surplus or deficit or the change in expected cash flows on the highly probable forecast transaction is based on the forward price for the commodity.

- AG150. Sometimes the hedging instrument offsets only part of the hedged risk. For example, a hedge would not be fully effective if the hedging instrument and hedged item are denominated in different currencies that do not move in tandem. Also, a hedge of interest rate risk using a derivative would not be fully effective if part of the change in the fair value of the derivative is attributable to the counterparty's credit risk.
- AG151. To qualify for hedge accounting, the hedge must relate to a specific identified and designated risk, and not merely to the entity's general operational risks, and must ultimately affect the entity's surplus or deficit. A hedge of the risk of obsolescence of a physical asset or the risk of legislative changes relating to the rehabilitation of damage to the environment is not eligible for hedge accounting; effectiveness cannot be measured because those risks are not measurable reliably.
- AG152. Paragraph 83(a) permits an entity to separate the intrinsic value and time value of an option contract and designate as the hedging instrument only the change in the intrinsic value of the option contract. Such a designation may result in a hedging relationship that is perfectly effective in achieving offsetting changes in cash flows attributable to a hedged one-sided risk of a forecast transaction, if the principal terms of the forecast transaction and hedging instrument are the same.
- AG153. If an entity designates a purchased option in its entirety as the hedging instrument of a one-sided risk arising from a forecast transaction, the hedging relationship will not be perfectly effective. This is because the premium paid for the option includes time value and, as stated in paragraph AG135, a designated one-sided risk does not include the time value of an option. Therefore, in this situation, there will be no offset between the cash flows relating to the time value of the option premium paid and the designated hedged risk.
- AG154. In the case of interest rate risk, hedge effectiveness may be assessed by preparing a maturity schedule for financial assets and financial liabilities that shows the net interest rate exposure for each time period, provided that the net exposure is associated with a specific asset or liability (or a specific group of assets or liabilities or a specific portion of them) giving rise to the net exposure, and hedge effectiveness is assessed against that asset or liability.
- AG155. In assessing the effectiveness of a hedge, an entity generally considers the time value of money. The fixed interest rate on a hedged item need not exactly match the fixed interest rate on a swap designated as a fair value hedge. Nor does the variable interest rate on an interest-bearing asset or liability need to be the same as the variable interest rate on a swap designated as a cash flow hedge. A swap's fair value derives from its net settlements. The fixed and variable rates on a swap can be changed

without affecting the net settlement if both are changed by the same amount.

- AG156. If an entity does not meet hedge effectiveness criteria, the entity discontinues hedge accounting from the last date on which compliance with hedge effectiveness was demonstrated. However, if the entity identifies the event or change in circumstances that caused the hedging relationship to fail the effectiveness criteria, and demonstrates that the hedge was effective before the event or change in circumstances occurred, the entity discontinues hedge accounting from the date of the event or change in circumstances.

Fair Value Hedge Accounting for a Portfolio Hedge of Interest Rate Risk

- AG157. For a fair value hedge of interest rate risk associated with a portfolio of financial assets or financial liabilities, an entity would meet the requirements of this Standard if it complies with the procedures set out in (a)–(i) and paragraphs AG158–AG175 below.

- (a) As part of its risk management process the entity identifies a portfolio of items whose interest rate risk it wishes to hedge. The portfolio may comprise only assets, only liabilities or both assets and liabilities. The entity may identify two or more portfolios (e.g., the entity may group its available-for-sale assets into a separate portfolio), in which case it applies the guidance below to each portfolio separately.
- (b) The entity analyses the portfolio into repricing time periods based on expected, rather than contractual, repricing dates. The analysis into repricing time periods may be performed in various ways including scheduling cash flows into the periods in which they are expected to occur, or scheduling notional principal amounts into all periods until repricing is expected to occur.
- (c) On the basis of this analysis, the entity decides the amount it wishes to hedge. The entity designates as the hedged item an amount of assets or liabilities (but not a net amount) from the identified portfolio equal to the amount it wishes to designate as being hedged. This amount also determines the percentage measure that is used for testing effectiveness in accordance with paragraph AG169(b).
- (d) The entity designates the interest rate risk it is hedging. This risk could be a portion of the interest rate risk in each of the items in the hedged position, such as a benchmark interest rate (e.g., a swap rate).

- (e) The entity designates one or more hedging instruments for each repricing time period.
- (f) Using the designations made in (c)–(e) above, the entity assesses at inception and in subsequent periods, whether the hedge is expected to be highly effective during the period for which the hedge is designated.
- (g) Periodically, the entity measures the change in the fair value of the hedged item (as designated in (c)) that is attributable to the hedged risk (as designated in (d)), on the basis of the expected repricing dates determined in (b). Provided that the hedge is determined actually to have been highly effective when assessed using the entity's documented method of assessing effectiveness, the entity recognizes the change in fair value of the hedged item as a gain or loss in surplus or deficit and in one of two line items in the statement of financial position as described in paragraph 100. The change in fair value need not be allocated to individual assets or liabilities.
- (h) The entity measures the change in fair value of the hedging instrument(s) (as designated in (e)) and recognizes it as a gain or loss in surplus or deficit. The fair value of the hedging instrument(s) is recognized as an asset or liability in the statement of financial position.
- (i) Any ineffectiveness will be recognized in surplus or deficit as the difference between the change in fair value referred to in (g) and that referred to in (h) (effectiveness is measured using the same materiality considerations as in other IPSASs).

AG158. This approach is described in more detail below. The approach shall be applied only to a fair value hedge of the interest rate risk associated with a portfolio of financial assets or financial liabilities.

AG159. The portfolio identified in paragraph AG157(a) could contain assets and liabilities. Alternatively, it could be a portfolio containing only assets, or only liabilities. The portfolio is used to determine the amount of the assets or liabilities the entity wishes to hedge. However, the portfolio is not itself designated as the hedged item.

AG160. In applying paragraph AG157(b), the entity determines the expected repricing date of an item as the earlier of the dates when that item is expected to mature or to reprice to market rates. The expected repricing dates are estimated at the inception of the hedge and throughout the term of the hedge, based on historical experience and other available information, including information and expectations regarding prepayment rates, interest rates and the interaction between them. Entities

that have no entity-specific experience or insufficient experience use peer group experience for comparable financial instruments. These estimates are reviewed periodically and updated in the light of experience. In the case of a fixed rate item that is prepayable, the expected repricing date is the date on which the item is expected to prepay unless it reprices to market rates on an earlier date. For a group of similar items, the analysis into time periods based on expected repricing dates may take the form of allocating a percentage of the group, rather than individual items, to each time period. An entity may apply other methodologies for such allocation purposes. For example, it may use a prepayment rate multiplier for allocating amortizing loans to time periods based on expected repricing dates. However, the methodology for such an allocation shall be in accordance with the entity's risk management procedures and objectives.

AG161. As an example of the designation set out in paragraph AG157(c), if in a particular repricing time period an entity estimates that it has fixed rate assets of CU100 and fixed rate liabilities of CU80 and decides to hedge all of the net position of CU20, it designates as the hedged item assets in the amount of CU20 (a portion of the assets is designated as the Standard permits an entity to designate any amount of the available qualifying assets or liabilities, i.e., in this example any amount of the assets between CU0 and CU100). The designation is expressed as an "amount of a currency" (e.g., an amount of dollars, euro, pounds or rand) rather than as individual assets. It follows that all of the assets (or liabilities) from which the hedged amount is drawn – i.e., all of the CU100 of assets in the above example – must be:

- (a) Items whose fair value changes in response to changes in the interest rate being hedged; and
- (b) Items that could have qualified for fair value hedge accounting if they had been designated as hedged individually. In particular, because paragraph 52 of the Standard specifies that the fair value of a financial liability with a demand feature (such as demand deposits and some types of time deposits) is not less than the amount payable on demand, discounted from the first date that the amount could be required to be paid, such an item cannot qualify for fair value hedge accounting for any time period beyond the shortest period in which the holder can demand payment. In the above example, the hedged position is an amount of assets. Hence, such liabilities are not a part of the designated hedged item, but are used by the entity to determine the amount of the asset that is designated as being hedged. If the position the entity wished to hedge was an amount of liabilities, the amount representing the designated hedged item must be drawn from fixed rate liabilities other than liabilities that the entity can be required to repay in an

earlier time period, and the percentage measure used for assessing hedge effectiveness in accordance with paragraph AG169(b) would be calculated as a percentage of these other liabilities. For example, assume that an entity estimates that in a particular repricing time period it has fixed rate liabilities of CU100, comprising CU40 of demand deposits and CU60 of liabilities with no demand feature, and CU70 of fixed rate assets. If the entity decides to hedge all of the net position of CU30, it designates as the hedged item liabilities of CU30 or 50 percent ($CU30 / (CU100 - CU40) = 50$ percent) of the liabilities with no demand feature.

AG162. The entity also complies with the other designation and documentation requirements set out in paragraph 98(a). For a portfolio hedge of interest rate risk, this designation and documentation specifies the entity's policy for all of the variables that are used to identify the amount that is hedged and how effectiveness is measured, including the following:

- (a) Which assets and liabilities are to be included in the portfolio hedge and the basis to be used for removing them from the portfolio.
- (b) How the entity estimates repricing dates, including what interest rate assumptions underlie estimates of prepayment rates and the basis for changing those estimates. The same method is used for both the initial estimates made at the time an asset or liability is included in the hedged portfolio and for any later revisions to those estimates.
- (c) The number and duration of repricing time periods.
- (d) How often the entity will test effectiveness and which of the two methods in paragraph AG169 it will use.
- (e) The methodology used by the entity to determine the amount of assets or liabilities that are designated as the hedged item and, accordingly, the percentage measure used when the entity tests effectiveness using the method described in paragraph AG169(b).
- (f) When the entity tests effectiveness using the method described in paragraph AG169(b), whether the entity will test effectiveness for each repricing time period individually, for all time periods in aggregate, or by using some combination of the two.

The policies specified in designating and documenting the hedging relationship shall be in accordance with the entity's risk management procedures and objectives. Changes in policies shall not be made arbitrarily. They shall be justified on the basis of changes in market conditions and other factors and be founded on and consistent with the entity's risk management procedures and objectives.

- AG163. The hedging instrument referred to in paragraph AG157(e) may be a single derivative or a portfolio of derivatives all of which contain exposure to the hedged interest rate risk designated in paragraph AG157(d). Such a portfolio of derivatives may contain offsetting risk positions. However, it may not include written options or net written options, because paragraph 86 of the Standard and paragraph AG127 do not permit such options to be designated as hedging instruments (except when a written option is designated as an offset to a purchased option). If the hedging instrument hedges the amount designated in paragraph AG157(c) for more than one repricing time period, it is allocated to all of the time periods that it hedges. However, the whole of the hedging instrument must be allocated to those repricing time periods because paragraph 84 of the Standard does not permit a hedging relationship to be designated for only a portion of the time period during which a hedging instrument remains outstanding.
- AG164. When the entity measures the change in the fair value of a prepayable item in accordance with paragraph AG157(g), a change in interest rates affects the fair value of the prepayable item in two ways: it affects the fair value of the contractual cash flows and the fair value of the prepayment option that is contained in a prepayable item. Paragraph 90 of the Standard permits an entity to designate a portion of a financial asset or financial liability, sharing a common risk exposure, as the hedged item, provided effectiveness can be measured. For prepayable items, paragraph 91 permits this to be achieved by designating the hedged item in terms of the change in the fair value that is attributable to changes in the designated interest rate on the basis of expected, rather than contractual, repricing dates. However, the effect that changes in the hedged interest rate have on those expected repricing dates shall be included when determining the change in the fair value of the hedged item. Consequently, if the expected repricing dates are revised (e.g., to reflect a change in expected prepayments), or if actual repricing dates differ from those expected, ineffectiveness will arise as described in paragraph AG169. Conversely, changes in expected repricing dates that (a) clearly arise from factors other than changes in the hedged interest rate, (b) are uncorrelated with changes in the hedged interest rate, and (c) can be reliably separated from changes that are attributable to the hedged interest rate (e.g., changes in prepayment rates clearly arising from a change in demographic factors or tax regulations rather than changes in interest rate) are excluded when determining the change in the fair value of the hedged item, because they are not attributable to the hedged risk. If there is uncertainty about the factor that gave rise to the change in expected repricing dates or the entity is not able to separate reliably the changes that arise from the hedged interest rate from those that arise from other factors, the change is assumed to arise from changes in the hedged interest rate.

AG165. The Standard does not specify the techniques used to determine the amount referred to in paragraph AG157(g), namely the change in the fair value of the hedged item that is attributable to the hedged risk. If statistical or other estimation techniques are used for such measurement, management must expect the result to approximate closely that which would have been obtained from measurement of all the individual assets or liabilities that constitute the hedged item. It is not appropriate to assume that changes in the fair value of the hedged item equal changes in the value of the hedging instrument.

AG166. Paragraph 100 requires that if the hedged item for a particular repricing time period is an asset, the change in its value is presented in a separate line item within assets. Conversely, if the hedged item for a particular repricing time period is a liability, the change in its value is presented in a separate line item within liabilities. These are the separate line items referred to in paragraph AG157(g). Specific allocation to individual assets (or liabilities) is not required.

AG167. Paragraph AG157(i) notes that ineffectiveness arises to the extent that the change in the fair value of the hedged item that is attributable to the hedged risk differs from the change in the fair value of the hedging derivative. Such a difference may arise for a number of reasons, including:

- (a) Actual repricing dates being different from those expected, or expected repricing dates being revised;
- (b) Items in the hedged portfolio becoming impaired or being derecognized;
- (c) The payment dates of the hedging instrument and the hedged item being different; and
- (d) Other causes (e.g., when a few of the hedged items bear interest at a rate below the benchmark rate for which they are designated as being hedged, and the resulting ineffectiveness is not so great that the portfolio as a whole fails to qualify for hedge accounting).

Such ineffectiveness (applying the same materiality considerations in other IPSASs) shall be identified and recognized in surplus or deficit.

AG168. Generally, the effectiveness of the hedge will be improved:

- (a) If the entity schedules items with different prepayment characteristics in a way that takes account of the differences in prepayment behavior.
- (b) When the number of items in the portfolio is larger. When only a few items are contained in the portfolio, relatively high ineffectiveness is likely if one of the items prepays earlier or later

than expected. Conversely, when the portfolio contains many items, the prepayment behavior can be predicted more accurately.

- (c) When the repricing time periods used are narrower (e.g., 1-month as opposed to 3-month repricing time periods). Narrower repricing time periods reduce the effect of any mismatch between the repricing and payment dates (within the repricing time period) of the hedged item and those of the hedging instrument.
- (d) The greater the frequency with which the amount of the hedging instrument is adjusted to reflect changes in the hedged item (e.g., because of changes in prepayment expectations).

AG169. An entity tests effectiveness periodically. If estimates of repricing dates change between one date on which an entity assesses effectiveness and the next, it shall calculate the amount of effectiveness either:

- (a) As the difference between the change in the fair value of the hedging instrument (see paragraph AG157(h)) and the change in the value of the entire hedged item that is attributable to changes in the hedged interest rate (including the effect that changes in the hedged interest rate have on the fair value of any embedded prepayment option); or
- (b) Using the following approximation. The entity:
 - (i) Calculates the percentage of the assets (or liabilities) in each repricing time period that was hedged, on the basis of the estimated repricing dates at the last date it tested effectiveness.
 - (ii) Applies this percentage to its revised estimate of the amount in that repricing time period to calculate the amount of the hedged item based on its revised estimate.
 - (iii) Calculates the change in the fair value of its revised estimate of the hedged item that is attributable to the hedged risk and presents it as set out in paragraph AG157(g).
 - (iv) Recognizes ineffectiveness equal to the difference between the amount determined in (iii) and the change in the fair value of the hedging instrument (see paragraph AG157(h)).

AG170. When measuring effectiveness, the entity distinguishes revisions to the estimated repricing dates of existing assets (or liabilities) from the origination of new assets (or liabilities), with only the former giving rise to ineffectiveness. All revisions to estimated repricing dates (other than those excluded in accordance with paragraph AG164), including any reallocation of existing items between time periods, are included when revising the estimated amount in a time period in accordance with

paragraph AG169(b)(ii) and hence when measuring effectiveness. Once ineffectiveness has been recognized as set out above, the entity establishes a new estimate of the total assets (or liabilities) in each repricing time period, including new assets (or liabilities) that have been originated since it last tested effectiveness, and designates a new amount as the hedged item and a new percentage as the hedged percentage. The procedures set out in paragraph AG169(b) are then repeated at the next date it tests effectiveness.

- AG171. Items that were originally scheduled into a repricing time period may be derecognized because of earlier than expected prepayment or write-offs caused by impairment or sale. When this occurs, the amount of change in fair value included in the separate line item referred to in paragraph AG157(g) that relates to the derecognized item shall be removed from the statement of financial position, and included in the gain or loss that arises on derecognition of the item. For this purpose, it is necessary to know the repricing time period(s) into which the derecognized item was scheduled, because this determines the repricing time period(s) from which to remove it and hence the amount to remove from the separate line item referred to in paragraph AG157(g). When an item is derecognized, if it can be determined in which time period it was included, it is removed from that time period. If not, it is removed from the earliest time period if the derecognition resulted from higher than expected prepayments, or allocated to all time periods containing the derecognized item on a systematic and rational basis if the item was sold or became impaired.
- AG172. In addition, any amount relating to a particular time period that has not been derecognized when the time period expires is recognized in surplus or deficit at that time (see paragraph 100). For example, assume an entity schedules items into three repricing time periods. At the previous redesignation, the change in fair value reported in the single line item in the statement of financial position was an asset of CU25. That amount represents amounts attributable to periods 1, 2 and 3 of CU7, CU8 and CU10, respectively. At the next redesignation, the assets attributable to period 1 have been either realized or rescheduled into other periods. Therefore, CU7 is derecognized from the statement of financial position and recognized in surplus or deficit. CU8 and CU10 are now attributable to periods 1 and 2, respectively. These remaining periods are then adjusted, as necessary, for changes in fair value as described in paragraph AG157(g).
- AG173. As an illustration of the requirements of the previous two paragraphs, assume that an entity scheduled assets by allocating a percentage of the portfolio into each repricing time period. Assume also that it scheduled CU100 into each of the first two time periods. When the first repricing time period expires, CU110 of assets are derecognized because of

expected and unexpected repayments. In this case, all of the amount contained in the separate line item referred to in paragraph AG157(g) that relates to the first time period is removed from the statement of financial position, plus 10 percent of the amount that relates to the second time period.

- AG174. If the hedged amount for a repricing time period is reduced without the related assets (or liabilities) being derecognized, the amount included in the separate line item referred to in paragraph AG157(g) that relates to the reduction shall be amortized in accordance with paragraph 104.
- AG175. An entity may wish to apply the approach set out in paragraphs AG157–AG174 to a portfolio hedge that had previously been accounted for as a cash flow hedge in accordance with IPSAS 29. Such an entity would revoke the previous designation of a cash flow hedge in accordance with paragraph 112(d), and apply the requirements set out in that paragraph. It would also redesignate the hedge as a fair value hedge and apply the approach set out in paragraphs AG157–AG174 prospectively to subsequent accounting periods.

Appendix B

Reassessment of Embedded Derivatives

This Appendix is an integral part of IPSAS 29.

Introduction

- B1. IPSAS 29 paragraph 11 describes an embedded derivative as “a component of a hybrid (combined) instrument that also includes a non-derivative host contract—with the effect that some of the cash flows of the combined instrument vary in a way similar to a stand-alone derivative.”
- B2. IPSAS 29 paragraph 12 requires an embedded derivative to be separated from the host contract and accounted for as a derivative if, and only if:
 - (a) The economic characteristics and risks of the embedded derivative are not closely related to the economic characteristics and risks of the host contract;
 - (b) A separate instrument with the same terms as the embedded derivative would meet the definition of a derivative; and
 - (c) The hybrid (combined) instrument is not measured at fair value with changes in fair value recognized in surplus or deficit (i.e., a derivative that is embedded in a financial asset or financial liability at fair value through surplus or deficit is not separated).
- B3. IPSAS 29 requires an entity, when it first becomes a party to a contract, to assess whether any embedded derivatives contained in the contract are required to be separated from the host contract and accounted for as derivatives under the Standard. This appendix addresses whether:
 - (a) IPSAS 29 requires such an assessment to be made only when the entity first becomes a party to the contract, or if the assessment should be reconsidered throughout the life of the contract.
 - (b) A first-time adopter makes its assessment on the basis of the conditions that existed when the entity first became a party to the contract, or those prevailing when the entity adopts this Standard for the first time.
- B4. This appendix applies to all embedded derivatives within the scope of IPSAS 29 except the acquisition of contracts with embedded derivatives in an entity combination or their possible reassessment at the date of acquisition.

Application of IPSAS 29 to the Reassessment of Embedded Derivatives

- B5. An entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative when the entity first becomes a party to the contract. Subsequent reassessment is

prohibited unless there is either (a) a change in the terms of the contract that significantly modifies the cash flows that otherwise would be required under the contract or (b) reclassification of a financial asset out of fair value through surplus or deficit category, in which cases an assessment is required. An entity determines whether a modification to cash flows is significant by considering the extent to which the expected future cash flows associated with the embedded derivative, the host contract or both have changed and whether the change is significant relative to the previously expected cash flows on the contract.

- B6. The assessment whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on reclassification of a financial asset out of the fair value through surplus or deficit category in accordance with paragraph B5 shall be made on the basis of the circumstances that existed when the entity first became a party to the contract.
- B7. On first time adoption of IPSAS 29, an entity shall assess whether an embedded derivative is required to be separated from the host contract and accounted for as a derivative on the basis of the conditions that existed at the later of the date it first became a party to the contract and the date a reassessment is required by paragraph B5.

Appendix C

Hedges of a Net Investment in a Foreign Operation

This Appendix is an integral part of IPSAS 29.

Introduction

- C1. Many reporting entities have investments in foreign operations (as defined in IPSAS 4, paragraph 10). Such foreign operations may be controlled entities, associates, joint ventures or branches. IPSAS 4 requires an entity to determine the functional currency of each of its foreign operations as the currency of the primary economic environment of that operation. When translating the results and financial position of a foreign operation into a presentation currency, the entity is required to recognize foreign exchange differences directly in net assets/equity until it disposes of the foreign operation.
- C2. Hedge accounting of the foreign currency risk arising from a net investment in a foreign operation will apply only when the net assets of that foreign operation are included in the financial statements. This will be the case for consolidated financial statements, financial statements in which investments are accounted for using the equity method, and financial statements in which venturers' interests in joint ventures are proportionately consolidated. The item being hedged with respect to the foreign currency risk arising from the net investment in a foreign operation may be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation.
- C3. IPSAS 29 requires the designation of an eligible hedged item and eligible hedging instruments in a hedge accounting relationship. If there is a designated hedging relationship, in the case of a net investment hedge, the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment is recognized directly in net assets/equity and is included with the foreign exchange differences arising on translation of the results and financial position of the foreign operation.
- C4. This appendix applies to an entity that hedges the foreign currency risk arising from its net investments in foreign operations and wishes to qualify for hedge accounting in accordance with IPSAS 29. It should not be applied by analogy to other types of hedge accounting. This appendix refers to such an entity as a controlling entity and to the financial statements in which the net assets of foreign operations are included as consolidated financial statements. All references to a controlling entity apply equally to an entity that has a net investment in a foreign operation that is a joint venture, an associate or a branch.
- C5. This appendix provides guidance on:

- (a) Identifying the foreign currency risks that qualify as a hedged risk in the hedge of a net investment in a foreign operation, given that an entity with many foreign operations may be exposed to a number of foreign currency risks. It specifically addresses:
 - (i) Whether the controlling entity may designate as a hedged risk only the foreign exchange differences arising from a difference between the functional currencies of the controlling entity and its foreign operation, or whether it may also designate as the hedged risk the foreign exchange differences arising from the difference between the presentation currency of the controlling entity's consolidated financial statements and the functional currency of the foreign operation; and
 - (ii) If the controlling entity holds the foreign operation indirectly, whether the hedged risk may include only the foreign exchange differences arising from differences in functional currencies between the foreign operation and its immediate controlling entity, or whether the hedged risk may also include any foreign exchange differences between the functional currency of the foreign operation and any intermediate or ultimate controlling entity (i.e., whether the fact that the net investment in the foreign operation is held through an intermediate controlling entity affects the economic risk to the ultimate controlling entity).
- (b) Where in an economic entity the hedging instrument can be held. It specifically addresses:
 - (i) IPSAS 29 allows an entity to designate either a derivative or a non-derivative financial instrument (or a combination of derivative and non-derivative financial instruments) as hedging instruments for foreign currency risk. This appendix addresses whether the nature of the hedging instrument (derivative or non-derivative) or the method of consolidation affects the assessment of hedge effectiveness.
 - (ii) This appendix also addresses where, within an economic entity, hedging instruments that are hedges of a net investment in a foreign operation can be held to qualify for hedge accounting i.e., whether a qualifying hedge accounting relationship can be established only if the entity hedging its net investment is a party to the hedging instrument or whether any entity within the economic entity, regardless of its functional currency, can hold the hedging instrument.
- (c) How an entity should determine what amount of the gain or loss recognized in net assets/equity should be recognized directly in surplus or deficit for both the hedging instrument and the hedged item as

IPSAS 4 and IPSAS 29 require cumulative amounts recognized directly in net assets/equity relating to both the foreign exchange differences arising on translation of the results and financial position of the foreign operation and the gain or loss on the hedging instrument that is determined to be an effective hedge of the net investment to be recognized directly when the controlling entity disposes of the foreign operation. It specifically addresses:

- (i) When a foreign operation that was hedged is disposed of, what amounts from the controlling entity's foreign currency translation reserve in respect of the hedging instrument and of that foreign operation should be recognized in surplus or deficit in the controlling entity's consolidated financial statements; and
- (ii) Whether the method of consolidation affects the determination of the amounts to be recognized in surplus or deficit.

Application of IPSAS 29 to Hedges of a Net Investment in a Foreign Operation

Nature of the Hedged Risk and Amount of the Hedged Item for which a Hedging Relationship may be Designated

- C6. Hedge accounting may be applied only to the foreign exchange differences arising between the functional currency of the foreign operation and the controlling entity's functional currency.
- C7. In a hedge of the foreign currency risks arising from a net investment in a foreign operation, the hedged item can be an amount of net assets equal to or less than the carrying amount of the net assets of the foreign operation in the consolidated financial statements of the controlling entity. The carrying amount of the net assets of a foreign operation that may be designated as the hedged item in the consolidated financial statements of a controlling entity depends on whether any lower level controlling entity of the foreign operation has applied hedge accounting for all or part of the net assets of that foreign operation and that accounting has been maintained in the controlling entity's consolidated financial statements.
- C8. The hedged risk may be designated as the foreign currency exposure arising between the functional currency of the foreign operation and the functional currency of any controlling entity (the immediate, intermediate or ultimate controlling entity) of that foreign operation. The fact that the net investment is held through an intermediate controlling entity does not affect the nature of the economic risk arising from the foreign currency exposure to the ultimate controlling entity.
- C9. An exposure to foreign currency risk arising from a net investment in a foreign operation may qualify for hedge accounting only once in the consolidated financial statements. Therefore, if the same net assets of a

foreign operation are hedged by more than one controlling entity within the economic entity (e.g., both a direct and an indirect controlling entity) for the same risk, only one hedging relationship will qualify for hedge accounting in the consolidated financial statements of the ultimate controlling entity. A hedging relationship designated by one controlling entity in its consolidated financial statements need not be maintained by another higher level controlling entity. However, if it is not maintained by the higher level controlling entity, the hedge accounting applied by the lower level controlling entity must be reversed before the higher level controlling entity's hedge accounting is recognized.

Where the Hedging Instrument can be Held

- C10. A derivative or a non-derivative instrument (or a combination of derivative and non-derivative instruments) may be designated as a hedging instrument in a hedge of a net investment in a foreign operation. The hedging instrument(s) may be held by any entity or entities within the economic entity (except the foreign operation that itself is being hedged), as long as the designation, documentation and effectiveness requirements of IPSAS 29 paragraph 98 that relate to a net investment hedge are satisfied. In particular, the hedging strategy of the economic entity should be clearly documented because of the possibility of different designations at different levels of the economic entity.
- C11. For the purpose of assessing effectiveness, the change in value of the hedging instrument in respect of foreign exchange risk is computed by reference to the functional currency of the controlling entity against whose functional currency the hedged risk is measured, in accordance with the hedge accounting documentation. Depending on where the hedging instrument is held, in the absence of hedge accounting the total change in value might be recognized in surplus or deficit, directly in net assets/equity, or both. However, the assessment of effectiveness is not affected by whether the change in value of the hedging instrument is recognized in surplus or deficit or directly in net assets/equity. As part of the application of hedge accounting, the total effective portion of the change is included directly in net assets/equity. The assessment of effectiveness is not affected by whether the hedging instrument is a derivative or a non-derivative instrument or by the method of consolidation.

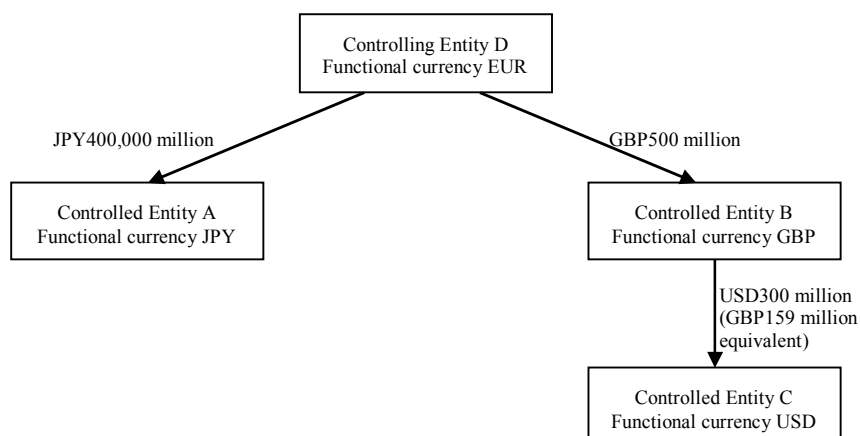
Disposal of a Hedged Foreign Operation

- C12. When a foreign operation that was hedged is disposed of, the amount reclassified to surplus or deficit from the foreign currency translation reserve in the consolidated financial statements of the controlling entity in respect of the hedging instrument is the amount that IPSAS 29 paragraph 113 requires to be identified. That amount is the cumulative gain or loss on the hedging instrument that was determined to be an effective hedge.

- C13. The amount recognized in surplus or deficit upon transfer from the foreign currency translation reserve in the consolidated financial statements of a controlling entity in respect of the net investment in that foreign operation in accordance with IPSAS 4 paragraph 57 is the amount included in that controlling entity's foreign currency translation reserve in respect of that foreign operation. In the ultimate controlling entity's consolidated financial statements, the aggregate net amount recognized in the foreign currency translation reserve in respect of all foreign operations is not affected by the consolidation method. However, whether the ultimate controlling entity uses the direct or the step-by-step method of consolidation, this may affect the amount included in its foreign currency translation reserve in respect of an individual foreign operation.
- C14. The direct method is the method of consolidation in which the financial statements of the foreign operation are translated directly into the functional currency of the ultimate controlling entity. The step-by-step method is the method of consolidation in which the financial statements of the foreign operation are first translated into the functional currency of any intermediate controlling entity(ies) and then translated into the functional currency of the ultimate controlling entity (or the presentation currency if different).
- C15. The use of the step-by-step method of consolidation may result in a different amount being recognized in surplus or deficit from that used to determine hedge effectiveness. This difference may be eliminated by determining the amount relating to that foreign operation that would have arisen if the direct method of consolidation had been used. Making this adjustment is not required by IPSAS 4. However, it is an accounting policy choice that should be followed consistently for all net investments.

Example

- C16. The following example illustrates the application of the preceding paragraphs using the entity structure illustrated below. In all cases the hedging relationships described would be tested for effectiveness in accordance with IPSAS 29, although this testing is not discussed. Controlling Entity D, being the ultimate controlling entity, presents its consolidated financial statements in its functional currency of euro (EUR). Each of the controlled entities i.e., Controlled Entity A, Controlled Entity B and Controlled Entity C, is wholly owned. Controlling Entity D £500 million net investment in Controlled Entity B (functional currency pounds sterling (GBP)) includes the £159 million equivalent of Controlled Entity B's US\$300 million net investment in Controlled Entity C (functional currency US dollars (USD)). In other words, Controlled Entity B's net assets other than its investment in Controlled Entity C are £341 million.



Nature of Hedged Risk for which a Hedging Relationship may be Designated (paragraphs C6–C9)

- C17. Controlling Entity D can hedge its net investment in each of Controlled Entities A, B and C for the foreign exchange risk between their respective functional currencies (Japanese yen (JPY), pounds sterling and US dollars) and euro. In addition, Controlling Entity D can hedge the USD/GBP foreign exchange risk between the functional currencies of Controlled Entity B and Controlled Entity C. In its consolidated financial statements, Controlled Entity B can hedge its net investment in Controlled Entity C for the foreign exchange risk between their functional currencies of US dollars and pounds sterling. In the following examples the designated risk is the spot foreign exchange risk because the hedging instruments are not derivatives. If the hedging instruments were forward contracts, Controlling Entity D could designate the forward foreign exchange risk.

Amount of Hedged item for which a Hedging Relationship may be Designated (paragraphs C6–C9)

- C18. Controlling Entity D wishes to hedge the foreign exchange risk from its net investment in Controlled Entity C. Assume that Controlled Entity A has an external borrowing of US\$300 million. The net assets of Controlled Entity A at the start of the reporting period are ¥400,000 million including the proceeds of the external borrowing of US\$300 million.
- C19. The hedged item can be an amount of net assets equal to or less than the carrying amount of Controlling Entity D's net investment in Controlled Entity C (US\$300 million) in its consolidated financial statements. In its consolidated financial statements Controlling Entity D can designate the US\$300 million external borrowing in Controlled Entity A as a hedge of the

EUR/USD spot foreign exchange risk associated with its net investment in the US\$300 million net assets of Controlled Entity C. In this case, both the EUR/USD foreign exchange difference on the US\$300 million external borrowing in Controlled Entity A and the EUR/USD foreign exchange difference on the US\$300 million net investment in Controlled Entity C are included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements after the application of hedge accounting.

C20. In the absence of hedge accounting, the total USD/EUR foreign exchange difference on the US\$300 million external borrowing in Controlled Entity A would be recognized in Controlling Entity D's consolidated financial statements as follows:

- USD/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
- JPY/EUR spot foreign exchange rate change directly in net assets/equity.

Instead of the designation in paragraph C19, in its consolidated financial statements Controlling Entity D can designate the US\$300 million external borrowing in Controlled Entity A as a hedge of the GBP/USD spot foreign exchange risk between Controlled Entity C and Controlled Entity B. In this case, the total USD/EUR foreign exchange difference on the US\$300 million external borrowing in Entity A would instead be recognized in Controlled Entity D's consolidated financial statements as follows:

- The GBP/USD spot foreign exchange rate change in the foreign currency translation reserve relating to Controlled Entity C;
- GBP/JPY spot foreign exchange rate change, translated to euro, in surplus or deficit; and
- JPY/EUR spot foreign exchange rate change directly in net assets/equity.

C21. Controlling Entity D cannot designate the US\$300 million external borrowing in Controlled Entity A as a hedge of both the EUR/USD spot foreign exchange risk and the GBP/USD spot foreign exchange risk in its consolidated financial statements. A single hedging instrument can hedge the same designated risk only once. Controlled Entity B cannot apply hedge accounting in its consolidated financial statements because the hedging instrument is held outside the economic entity comprising Controlled Entity B and Controlled Entity C.

Where in an Economic Entity can the Hedging Instrument be Held (paragraphs C10 and C11)?

- C22. As noted in paragraph C20, the total change in value in respect of foreign exchange risk of the US\$300 million external borrowing in Controlled Entity A would be recorded in both surplus or deficit (USD/JPY spot risk) and directly in net assets/equity (EUR/JPY spot risk) in Controlling Entity D's consolidated financial statements in the absence of hedge accounting. Both amounts are included for the purpose of assessing the effectiveness of the hedge designated in paragraph C19 because the change in value of both the hedging instrument and the hedged item are computed by reference to the euro functional currency of Controlling Entity D against the US dollar functional currency of Controlled Entity C, in accordance with the hedge documentation. The method of consolidation (i.e., direct method or step-by-step method) does not affect the assessment of the effectiveness of the hedge.

Amounts Recognized in Surplus or Deficit on Disposal of a Foreign Operation (paragraphs C12 and C13)

- C23. When Controlled Entity C is disposed of, the amounts are recognized in surplus or deficit in Controlling Entity D's consolidated financial statements upon transfer from its foreign currency translation reserve (FCTR) are:
- (a) In respect of the US\$300 million external borrowing of Controlled Entity A, the amount that IPSAS 29 requires to be identified, i.e., the total change in value in respect of foreign exchange risk that was recognized directly in net assets/equity as the effective portion of the hedge; and
 - (b) In respect of the US\$300 million net investment in Controlled Entity C, the amount determined by the entity's consolidation method. If Controlling Entity D uses the direct method, its FCTR in respect of Controlled Entity C will be determined directly by the EUR/USD foreign exchange rate. If Controlling Entity D uses the step-by-step method, its FCTR in respect of Controlled Entity C will be determined by the FCTR recognized by Controlled Entity B reflecting the GBP/USD foreign exchange rate, translated to Controlling Entity D's functional currency using the EUR/GBP foreign exchange rate. Controlling Entity D's use of the step-by-step method of consolidation in prior periods does not require it to or preclude it from determining the amount of FCTR to be recognized in surplus or deficit when it disposes of Controlled Entity C to be the amount that it would have recognized if it had always used the direct method, depending on its accounting policy.

Hedging More Than One Foreign Operation (paragraphs C7, C9, and C11)

- C24. The following examples illustrate that in the consolidated financial statements of Controlling Entity D, the risk that can be hedged is always the risk between its functional currency (euro) and the functional currencies of Controlled Entities B and C. No matter how the hedges are designated, the maximum amounts that can be effective hedges to be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements when both foreign operations are hedged are US\$300 million for EUR/USD risk and £341 million for EUR/GBP risk. Other changes in value due to changes in foreign exchange rates are included in Controlling Entity D's consolidated surplus or deficit. Of course, it would be possible for Controlling Entity D to designate US\$300 million only for changes in the USD/GBP spot foreign exchange rate or £500 million only for changes in the GBP/EUR spot foreign exchange rate.

Entity D Holds Both USD and GBP Hedging Instruments

- C25. Controlling Entity D may wish to hedge the foreign exchange risk in relation to its net investment in Controlled Entity B as well as that in relation to Controlled Entity C. Assume that Controlling Entity D holds suitable hedging instruments denominated in US dollars and pounds sterling that it could designate as hedges of its net investments in Controlled Entity B and Controlled Entity C. The designations Controlling Entity D can make in its consolidated financial statements include, but are not limited to, the following:
- (a) US\$300 million hedging instrument designated as a hedge of the US\$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (EUR/USD) between Controlling Entity D and Controlled Entity C and up to £341 million hedging instrument designated as a hedge of £341 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.
 - (b) US\$300 million hedging instrument designated as a hedge of the US\$300 million of net investment in Controlled Entity C with the risk being the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C and up to £500 million hedging instrument designated as a hedge of £500 million of the net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (EUR/GBP) between Controlling Entity D and Controlled Entity B.
- C26. The EUR/USD risk from Controlling Entity D's net investment in Controlled Entity C is a different risk from the EUR/GBP risk from Controlling Entity

D's net investment in Controlled Entity B. However, in the case described in paragraph C25(a), by its designation of the USD hedging instrument it holds, Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C. If Controlling Entity D also designated a GBP instrument it holds as a hedge of its £500 million net investment in Controlled Entity B, £159 million of that net investment, representing the GBP equivalent of its USD net investment in Controlled Entity C, would be hedged twice for GBP/EUR risk in Controlling Entity D's consolidated financial statements.

- C27. In the case described in paragraph C25(b), if Controlling Entity D designates the hedged risk as the spot foreign exchange exposure (GBP/USD) between Controlled Entity B and Controlled Entity C, only the GBP/USD part of the change in the value of its US\$300 million hedging instrument is included in Controlling Entity D's foreign currency translation reserve relating to Controlled Entity C. The remainder of the change (equivalent to the GBP/EUR change on £159 million) is included in Controlling Entity D's consolidated surplus or deficit, as in paragraph C20. Because the designation of the USD/GBP risk between Controlled entities B and C does not include the GBP/EUR risk, Controlled Entity D is also able to designate up to £500 million of its net investment in Controlled Entity B with the risk being the spot foreign exchange exposure (GBP/EUR) between Controlling Entity D and Controlled Entity B.

Entity B Holds the USD Hedging Instrument

- C28. Assume that Controlled Entity B holds US\$300 million of external debt, the proceeds of which were transferred to Controlling Entity D by an inter-entity loan denominated in pounds sterling. Because both its assets and liabilities increased by £159 million, Controlled Entity B's net assets are unchanged. Controlled Entity B could designate the external debt as a hedge of the GBP/USD risk of its net investment in Controlled Entity C in its consolidated financial statements. Controlling Entity D could maintain Controlled Entity B's designation of that hedging instrument as a hedge of its US\$300 million net investment in Controlled Entity C for the GBP/USD risk (see paragraph C9) and Controlling Entity D could designate the GBP hedging instrument it holds as a hedge of its entire £500 million net investment in Controlled Entity B. The first hedge, designated by Controlled Entity B, would be assessed by reference to Controlled Entity B's functional currency (pounds sterling) and the second hedge, designated by Controlling Entity D, would be assessed by reference to Controlling Entity D's functional currency (euro). In this case, only the GBP/USD risk from Controlling Entity D's net investment in Controlled Entity C has been hedged in Controlling Entity D's consolidated financial statements by the USD hedging instrument, not the entire EUR/USD risk. Therefore, the entire EUR/GBP risk from Controlling Entity D's £500

million net investment in Controlled Entity B may be hedged in the consolidated financial statements of Controlling Entity D.

- C29. However, the accounting for Controlled Entity D's £159 million loan payable to Controlled Entity B must also be considered. If Controlling Entity D's loan payable is not considered part of its net investment in Controlled Entity B because it does not satisfy the conditions in IPSAS 4 paragraph 18, the GBP/EUR foreign exchange difference arising on translating it would be included in Controlling Entity D's consolidated surplus or deficit. If the £159 million loan payable to Controlled Entity B is considered part of Controlling Entity D's net investment, that net investment would be only £341 million and the amount Controlling Entity D could designate as the hedged item for GBP/EUR risk would be reduced from £500 million to £341 million accordingly.
- C30. If Controlling Entity D reversed the hedging relationship designated by Controlled Entity B, Controlling Entity D could designate the US\$300 million external borrowing held by Controlled Entity B as a hedge of its US\$300 million net investment in Controlled Entity C for the EUR/USD risk and designate the GBP hedging instrument it holds itself as a hedge of only up to £341 million of the net investment in Controlled Entity B. In this case the effectiveness of both hedges would be computed by reference to Controlling Entity D's functional currency (euro). Consequently, both the USD/GBP change in value of the external borrowing held by Controlled Entity B and the GBP/EUR change in value of Controlling Entity D's loan payable to Controlled Entity B (equivalent to USD/EUR in total) would be included in the foreign currency translation reserve in Controlling Entity D's consolidated financial statements. Because Controlling Entity D has already fully hedged the EUR/USD risk from its net investment in Controlled Entity C, it can hedge only up to £341 million for the EUR/GBP risk of its net investment in Controlled Entity B.

Appendix D

Amendments to Other IPSASs

The references to “relevant international or national accounting standards dealing with the recognition and measurement of financial instruments” are amended to “IPSAS 29, *Financial Instruments: Recognition and Measurement* in the following IPSASs:

- (a) IPSAS 1, *Presentation of Financial Statements* paragraphs 79, 82, and 101
- (b) IPSAS 4, *The Effects of Changes in Foreign Exchange Rates* paragraphs 3(a), 4, 31, and 61(a)
- (c) IPSAS 6, *Consolidated and Separate Financial Statements* paragraphs 22, 52, 61, and IG8
- (d) IPSAS 7, *Investments in Associates* paragraphs 1, 2, 20, 21, 24, 25, 37, 38, and 39
- (e) IPSAS 8, *Interests in Joint Ventures* paragraph 1, 2, 47, 48, and 58
- (f) IPSAS 9, *Revenue from Exchange Transactions* paragraph 10(c)
- (g) IPSAS 21, *Impairment of Non-Cash-Generating Assets* paragraphs 2(c) and 9
- (h) IPSAS 26, *Impairment of Cash-Generating Assets* paragraphs 2(c) and 8

IPSAS 4, *The Effects of Changes in Foreign Exchange Rates*

Paragraph 5 is amended as follows:

5. This Standard does not apply to hedge accounting for foreign currency items, including the hedging of a net investment in a foreign operation. ~~Accordingly, entities may apply the relevant international or national accounting standards dealing with hedge accounting.~~ IPSAS 29 applies to hedge accounting.

IPSAS 6, *Consolidated and Separate Financial Statements*

Paragraph 58(c) is amended as follows:

58. ...
 - (c) As financial instruments: in accordance with IPSAS 29.

IPSAS 9, Revenue from Exchange Transactions

Paragraph 10 in the Rendering of Services Section in the Implementation Guidance is amended as follows:

Appendix**IG12. Financial service fees**

The recognition of revenue for financial service fees depends on the purposes for which the fees are assessed and the basis of accounting for any associated financial instrument. The description of fees for financial services may not be indicative of the nature and substance of the services provided. Therefore, it is necessary to distinguish between fees that are an integral part of the effective interest rate of a financial instrument, fees that are earned as services are provided, and fees that are earned on the execution of a significant act.

- (a) *Fees that are an integral part of the effective ~~yield~~-interest rate of a financial instrument*

Such fees are generally treated as an adjustment to the effective ~~yield~~ interest rate. However, when the financial instrument ~~is to be measured at fair value subsequent to its initial recognition with the change in fair value recognized in surplus or deficit~~, the fees are recognized as revenue when the instrument is initially recognized.

- (i) Origination fees received by the entity relating to the creation or acquisition of a financial asset other than one that under IPSAS 29 is classified as a financial asset "at fair value through surplus or deficit"

Such fees may include compensation for activities such as evaluating the borrower's financial condition, evaluating and recording guarantees, collateral and other security arrangements, negotiating the terms of the instrument, preparing and processing documents and closing the transaction. These fees are an integral part of generating an involvement with the resulting financial instrument and, together with the related transaction costs (as defined in IPSAS 29), are deferred and recognized as an adjustment to the effective interest rate.

- (ii) Commitment fees received by the entity to originate a loan when the loan commitment is outside the scope of IPSAS 29

If it is probable that the entity will enter into a specific lending arrangement and the loan commitment is not within the scope of IPSAS 29, the commitment fee received is regarded as compensation for an ongoing involvement with the acquisition

of a financial instrument and, together with the related transaction costs (as defined in IPSAS 29), is deferred and recognized as an adjustment to the effective interest rate. If the commitment expires without the entity making the loan, the fee is recognized as revenue on expiry. Loan commitments that are within the scope of IPSAS 29 are accounted for as derivatives and measured at fair value.

(iii) Origination fees received on issuing financial liabilities measured at amortized cost

These fees are an integral part of generating an involvement with a financial liability. When a financial liability is not classified as “at fair value through surplus or deficit,” the origination fees received are included, with the related transaction costs (as defined in IPSAS 29) incurred, in the initial carrying amount of the financial liability and recognized as an adjustment to the effective interest rate. An entity distinguishes fees and costs that are an integral part of the effective interest rate for the financial liability from origination fees and transaction costs relating to the right to provide services, such as investment management services.

(b) *Fees earned as services are provided*

(i) *Fees charged for servicing a loan*

Fees charged by an entity for servicing a loan are recognized as revenue as the services are provided. ~~If the entity sells a loan but retains the servicing of that loan at a fee which is lower than a normal fee for such services, part of the sales price of the loan is deferred and recognized as revenue as the servicing is provided.~~

(ii) *Commitment fees to originate ~~or purchase~~ a loan when the loan commitment is outside the scope of IPSAS 29*

If it is unlikely that a specific lending arrangement will be entered into and the loan commitment is outside the scope of IPSAS 29, the commitment fee is recognized as revenue on a time proportion basis over the commitment period. Loan commitments that are within the scope of IPSAS 29 are accounted for as derivatives and measured at fair value.

(iii) Investment management fees

Fees charged for managing investments are recognized as revenue as the services are provided.

Incremental costs that are directly attributable to securing an investment management contract are recognized as an asset if they can be identified separately and measured reliably and if it is probable that they will be recovered. As in IPSAS 29, an incremental cost is one that would not have been incurred if the entity had not secured the investment management contract. The asset represents the entity's contractual right to benefit from providing investment management services, and is amortized as the entity recognizes the related revenue. If the entity has a portfolio of investment management contracts, it may assess their recoverability on a portfolio basis.

Some financial services contracts involve both the origination of one or more financial instruments and the provision of investment management services. An example is a long-term monthly saving contract linked to the management of a pool of equity securities. The provider of the contract distinguishes the transaction costs relating to the origination of the financial instrument from the costs of securing the right to provide investment management services.

- (c) *Fees that are earned on the execution of a significant act, ~~which is much more significant than any other act~~*

The fees are recognized as revenue when the significant act has been completed, as in the examples below.

- (i) *Commission on the allotment of shares to a client*

The commission is recognized as revenue when the shares have been allotted.

- (ii) *Placement fees for arranging a loan between a borrower and an investor*

The fee is recognized as revenue when the loan has been arranged.

- (iii) *Loan syndication fees*

A syndication fee received by an entity that arranges a loan and retains no part of the loan package for itself (or retains a part at the same effective interest rate for comparable risk as other participants) is compensation for the service of syndication. Such a fee is recognized as revenue when the syndication has been completed.

IPSAS 12, *Inventories***Paragraph 2(b) is amended as follows:**

2. ...
- (b) Financial instruments (see IPSAS 28, *Financial Instruments: Presentation* and IPSAS 29, *Financial Instruments: Recognition and Measurement*).

IPSAS 21, *Impairment of Non-Cash-Generating Assets***Paragraph 2(c) is amended as follows:**

2. ...
- (c) Financial assets that are included in the scope of ~~IPSAS 15, “Financial Instruments: Disclosure and Presentation”~~ IPSAS 29, *Financial Instruments: Recognition and Measurement*.

Paragraph 9 is amended as follows:

9. This Standard does not apply to financial assets that are included in the scope of ~~IPSAS 15~~ IPSAS 28, *Financial Instruments: Presentation*. Impairment of these assets ~~will be dealt with in any IPSAS that the IPSASB develops on the basis of IAS 39, “Financial Instruments: Recognition and Measurement to deal with the recognition and measurement of financial instruments~~ is dealt with in IPSAS 29.

IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)***Paragraph 5 is amended as follows:**

5. This Standard addresses revenue arising from non-exchange transactions. Revenue arising from exchange transactions is addressed in IPSAS 9, *Revenue from Exchange Transactions*. While revenues received by public sector entities arise from exchange and non-exchange transactions, the majority of revenue of governments and other public sector entities is typically derived from non-exchange transactions such as:
- (a) Taxes; and
- (b) Transfers (whether cash or non-cash), including grants, debt forgiveness, fines, bequests, gifts, donations, ~~and~~ goods and services in-kind, and the off-market portion of concessionary loans received.

Paragraph 10 is amended as follows:

10. There is a further group of non-exchange transactions where the entity may provide some consideration directly in return for the resources received, but that consideration does not approximate the fair value of the resources received. In these cases the entity determines whether there is a combination

of exchange and non-exchange transactions, each component of which is recognized separately. For example, an entity receives CU6 million funding from a multi-lateral development agency. The agreement stipulates that the entity must repay CU5 million of the funding received over a period of 10 years, at 5% interest when the market rate for a similar loan is 11%. The entity has effectively received a CU1 million grant (CU6 million received less CU5 million to be repaid) and entered into CU5 million concessionary loan which attracts interest at 6% below the market interest rate for a similar loan. The CU1 million grant received, as well as the off-market portion of the interest payments in terms of the agreement, are non-exchange transactions. The contractual capital and interest payments over the period of the loan are exchange transactions.

Paragraph 87 is amended as follows:

87. Revenue arising from debt forgiveness is measured at the carrying amount of the debt forgiven. ~~fair value of the debt forgiven. This will normally be the carrying amount of the debt forgiven.~~

An additional header and paragraphs are inserted after paragraph 105 as follows:

Concessionary Loans

105A. Concessionary loans are loans received by an entity at below market terms. The portion of the loan that is repayable, along with any interest payments, is an exchange transaction and is accounted for in accordance with IPSAS 29, *Financial Instruments: Recognition and Measurement*. An entity considers whether any difference between the transaction price (loan proceeds) and the fair value of the loan on initial recognition (see IPSAS 29) is non-exchange revenue that should be accounted for in accordance with this Standard.

105B. Where an entity determines that the difference between the transaction price (loan proceeds) and the fair value of the loan on initial recognition is non-exchange revenue, an entity recognizes the difference as revenue, except if a present obligation exists, e.g., where specific conditions imposed on the transferred assets by the recipient result in a present obligation. Where a present obligation exists, it is recognized as a liability. As the entity satisfies the present obligation, the liability is reduced and an equal amount of revenue is recognized.

An additional sub-paragraph is inserted after paragraph 106(c) as follows:

106.

- (cA) The amount of liabilities recognized in respect of concessionary loans that are subject to conditions on transferred assets;**

An additional paragraph is included after paragraph 124A:

124B IPSAS 29 amended paragraphs 4, 10, 87, and 106, and inserted paragraphs 105A and 105B. An entity shall apply the amendments for annual financial statements covering periods beginning on or after January 1, 2013. If an entity applies IPSAS 29 for a period beginning before January 1, 2013, the amendments shall also be applied for that earlier period.

In the Implementation Guidance an additional example is inserted after paragraph IG53 as follows:

Implementation Guidance

Concessionary Loans (paragraphs 105A to 105B)

IG54. An entity receives CU6 million funding from a multi-lateral development agency to build 10 schools over the next 5 years. The funding is provided on the following conditions:

- CU1 million of the funding need not be repaid, provided that the schools are built.
- CU5 million of the funding is to be repaid as follows:
Year 1: no capital to be repaid
Year 2: 10% of the capital to be repaid
Year 3: 20% of the capital to be repaid
Year 4: 30% of the capital to be repaid
Year 5: 40% of the capital to be repaid
- Interest is charged at 5% per annum over the period of the loan (assume interest is paid annually in arrears). The market rate of interest for a similar loan is 10%.
- To the extent that schools have not been built, the funding provided should be returned to the donor (assume that the donor has effective monitoring systems in place and has a past history of requiring any unspent funds to be returned).
- The entity built the following schools over the period of the loan:
Year 1: 1 school completed
Year 2: 3 schools completed
Year 3: 5 schools completed
Year 4: 10 schools completed

Analysis:

The entity has effectively received a grant of CU1 million and a loan of CU5 million (Note: An entity would consider whether the substance of the CU1 million is a contribution from owners or revenue; assume for purposes of this example that the CU1 million is revenue). It has also received an additional grant of CU784,550 (which is the difference between the proceeds of the loan of CU5 million and the present value of the contractual cash flows of the loan, discounted using the market related rate of interest of 10%).

The grant of CU1 million + CU784,550 is accounted for in accordance with this Standard and, the loan with its related contractual interest and capital payments, in accordance with IPSAS 29.

1. On initial recognition, the entity will recognize the following:

<u>Dr</u>	<u>Bank</u>	<u>CU6,000,000</u>	
	<u>Cr</u>	<u>Loan</u>	<u>CU4,215,450</u>
	<u>Cr</u>	<u>Liability</u>	<u>CU1,784,550</u>

2. Year 1: the entity will recognize the following:

<u>Dr</u>	<u>Liability</u>	<u>CU178,455</u>	
	<u>Cr</u>	<u>Non-exchange revenue</u>	<u>CU178,455</u>

(1/10 of the schools built X CU1,784,550)

(Note: The journal entries for the repayment of interest and capital and interest accruals, have not been reflected in this example as it is intended to illustrate the recognition of revenue arising from concessionary loans. Comprehensive examples are included in the Illustrative Examples to IPSAS 29).

3. Year 2: the entity will recognize the following (assuming that the entity subsequently measures the concessionary loan at amortized cost):

<u>Dr</u>	<u>Liability</u>	<u>CU356,910</u>	
	<u>Cr</u>	<u>Non-exchange revenue</u>	<u>CU356,910</u>

3/10 schools built X CU1,784,500 – CU178,455 already recognized)

4. Year 3: the entity will recognize the following:

<u>Dr</u>	<u>Liability</u>	<u>CU356,910</u>	
	<u>Cr</u>	<u>Non-exchange revenue</u>	<u>CU356,910</u>

(5/10 schools built X CU1,784,550 – CU535,365 already recognized)

5. Year 4: the entity will recognize the following:

<u>Dr</u>	<u>Liability</u>	<u>CU892,275</u>	
	<u>Cr</u>	<u>Non-exchange revenue</u>	<u>CU892,275</u>

(All schools built, CU1,784,550 – CU892,275)

If the concessionary loan was granted with no conditions, the entity would recognize the following on initial recognition:

<u>Dr</u>	<u>Bank</u>	<u>CU6,000,000</u>	
	<u>Cr</u>	<u>Loan</u>	<u>CU4,215,450</u>
	<u>Cr</u>	<u>Non-exchange revenue</u>	<u>CU1,784,550</u>

IPSAS 26, *Impairment of Cash-Generating Assets*

Paragraph 2(c) is amended as follows:

- (c) Financial assets that are within the scope of ~~IPSAS 15, “Financial Instruments: Disclosure and Presentation”~~ IPSAS 29, *Financial Instruments: Recognition and Measurement*;

Paragraph 9 is amended as follows:

9. This Standard does not apply to financial assets that are included in the scope of ~~IPSAS 15~~ IPSAS 28, *Financial Instruments: Presentation*. Impairment of these assets ~~will be dealt with in any IPSAS that the IPSASB develops to deal with the recognition and measurement of financial instruments~~ is dealt with in IPSAS 29.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 29.

Introduction

- BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 29, *Financial Instruments: Recognition and Measurement*. As this Standard is based on IAS 39, *Financial Instruments: Recognition and Measurement* issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 29 departs from the main requirements of IAS 39.
- BC2. This project on financial instruments forms part of the IPSASB's convergence program which aims to converge IPSASs with IFRSs. The IPSASB acknowledges that there are other aspects of financial instruments, insofar as they relate to the public sector, which are not addressed in IAS 39. These will be addressed by future projects of the IPSASB. In particular, the IPSASB acknowledges that future projects are required to address:
- Certain transactions undertaken by central banks; and
 - Receivables and payables that arise from arrangements that are, in substance, similar to, and have the same economic effect as, financial instruments, but are not contractual in nature.
- BC3. In developing this Standard, the IPSASB agreed to retain the existing text of IAS 39 wherever consistent with existing IPSASs, and deal with certain public sector specific issues through additional application guidance.
- BC4. In September 2007, the IASB issued amendments to IAS 1, *Presentation of Financial Statements* which introduced "comprehensive income" into the presentation of financial statements. As the IPSASB has not yet considered comprehensive income, along with some of the other amendments proposed in IAS 1, those amendments have not been included in IPSAS 29. The text of IAS 39 as published at December 31, 2008, including certain amendments made by the IASB to IAS 39 in April 2009 as part of its improvements project, have been included in the text of IPSAS 29. The IPSASB acknowledged that IFRS 9, *Financial Instruments* was issued in November 2009. The IPSASB also recognized that the IASB plans further significant modifications to IAS 39. The IPSASB therefore decided to consider any modifications to IASB requirements for financial instruments as part of a future project.

Scope

- BC5. Assets and liabilities may arise out of contractual non-exchange revenue transactions. The initial recognition and measurement of assets and

liabilities arising out of non-exchange revenue transactions is addressed in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*. IPSAS 23 does not provide requirements and guidance for the subsequent measurement or derecognition of these assets and liabilities. The IPSASB considered the interaction between this Standard and IPSAS 23 for assets and liabilities that arise out of non-exchange revenue transactions that meet the definition of financial assets and financial liabilities.

- BC6. The IPSASB agreed that where an asset acquired in a non-exchange transaction is a financial asset, an entity:
- Initially recognizes the asset using IPSAS 23; and
 - Initially measures the asset using IPSAS 23 and, considers the requirements in this Standard to determine the appropriate treatment for any transaction costs incurred to acquire the asset.

As IPSAS 23 does not prescribe subsequent measurement or derecognition requirements for assets acquired in a non-exchange transaction, this Standard is applied to those assets if they are financial assets.

- BC7. For liabilities, the IPSASB agreed that liabilities arising from conditions imposed on a transfer of resources in accordance with IPSAS 23 are initially recognized and initially measured using that IPSAS, as these liabilities usually do not meet the definition of a financial liability at initial recognition (see IPSAS 28). After initial recognition, if circumstances indicate that the liability is a financial liability, an entity assesses if the liability recognized in accordance with IPSAS 23 should be derecognized and a financial liability recognized in accordance with this Standard.
- BC8. The IPSASB agreed that other liabilities that arise from non-exchange revenue transactions, for example, the return of resources based on a restriction on the use of an asset, are recognized and measured in accordance with this Standard if they meet the definition of a financial liability.

Initial Measurement

- BC9. The IPSASB acknowledged that there is an interaction between IPSAS 23 and this Standard for assets acquired through a non-exchange transaction that also meet the definition of a financial asset. IPSAS 23 requires that assets acquired in a non-exchange revenue transaction are measured initially at fair value. This Standard requires financial assets to be measured initially at fair value, plus transaction costs, if the asset is not subsequently measured at fair value through surplus or deficit. The two measurement approaches are broadly consistent, except for the treatment of transaction costs.

BC10. The IPSASB concluded that it would be inappropriate for financial assets arising from non-exchange transactions to be measured differently from those arising from exchange transactions. Consequently, the IPSASB agreed that assets acquired in a non-exchange transaction should be measured initially at fair value using the requirements in IPSAS 23, but that this Standard should also be considered where transaction costs are incurred to acquire the asset.

Concessionary Loans

BC11. Concessionary loans can either be granted or received by an entity. They pose particular accounting issues because their terms are not market related. The IPSASB therefore considered how the off-market portion of a concessionary loan should be accounted for. In ED 38, the IPSASB proposed that an entity should account for concessionary loans by analyzing the substance of the transaction into its component parts and accounting for each component separately and that the IPSASB therefore determined that the off-market portion of a concessionary loan should be accounted for as follows:

- The issuer of a concessionary loan accounts for the off-market portion of the loan as an expense in the year the loan is issued; and
- The recipient of a concessionary loan accounts for the off-market portion of the loan in accordance with IPSAS 23.

BC12. Some respondents to ED 38 disagreed with the proposed treatment of concessionary loans because they do not believe that fair value is an appropriate measurement basis, while others disagreed with the proposed treatment of the off-market portion of concessionary loans as an expense.

BC13. Respondents who disagreed with fair value as a measurement basis cited both conceptual and practical difficulties in measuring concessionary loans at fair value. At a conceptual level, it was noted that some concessionary loans issued by public sector entities may not be available in an orderly market because of the risk profiles of the borrowers, e.g., small business loans, or loans granted by governments in their capacity as a lender of last resort. For loans that would not ordinarily be found in an orderly market, respondents argued that while it may be possible to obtain a fair value, that fair value does not provide a faithful representation of the transaction. They argued that because an orderly market for such transactions does not exist, the transaction price on initial measurement represents the fair value of the loan. Those respondents who cited practical difficulties in determining fair value noted that, because of these difficulties, fair values are often determined using estimates. In their view the use of such estimates would make the information potentially unreliable. As a means of overcoming these practical difficulties, respondents suggested that, as an alternative to

fair value, nominal cost or the lender's borrowing rate should be used as a measurement basis.

- BC14. The IPSASB takes the view that the use of fair value enables the most faithfully representative determination of the concession element of a concessionary loan. Also, because the loans granted at no or low interest are not unique to the public sector, the IPSASB was not persuaded that there is a public sector specific reason to depart from the fair value principles in IAS 39. They also noted that IPSAS 30 requires specific disclosures on the measurement of financial instruments, including those instances where unobservable market inputs have been used. Consequently, the IPSASB decided to retain fair value as a measurement basis for concessionary loans.
- BC15. Respondents who disagreed with expensing the off-market portion of the concessionary loan, noted that because the off-market portion represents a subsidy, it may be more appropriate to recognize an asset initially and recognize an expense subsequently by reducing this asset as and when the conditions of the subsidy are met or on a time proportion basis. The IPSASB, however, considered that the initial granting of the loan results in a commitment of resources, in the form of a loan and a subsidy, on day one. The IPSASB was of the view that initial recognition of this subsidy as an expense on recognition of the transaction provides the most useful information for accountability purposes.

Financial Guarantees Issued Through a Non-Exchange Transaction

- BC16. The IPSASB acknowledged that in the public sector financial guarantee contracts are frequently issued through a non-exchange transaction, i.e., they are issued for no consideration or for nominal consideration, often in order to further the issuer's broad social policy objectives, rather than for commercial purposes. While entities may issue guarantees at below fair value in the private sector, this is not common and is for commercial reasons, such as when a controlling entity issues a guarantee to a holder on behalf of a controlled entity. In the public sector the maximum credit risk exposure of such guarantees may be extremely large. Such guarantees are generally issued because an active market does not exist and, in some cases, it would be impossible for the guarantee to be provided by a private sector issuer because of the maximum extent of the credit risk exposure. The IPSASB considered the approach to measurement at initial recognition, and subsequent to initial recognition, for such financial guarantee contracts.
- BC17. Where the financial guarantee contract is entered into for consideration, the IPSASB considered whether the amount of such consideration should be deemed to be a fair value. Application Guidance in IAS 39 states that "the fair value of a financial instrument on initial recognition is normally the transaction price." In the public sector the IPSASB considered that in many cases the transaction price related to a financial guarantee contract will not

reflect fair value and that recognition at such an amount would be an inaccurate and misleading reflection of the issuer's exposure to financial risk. The IPSASB concluded that where there is consideration for a financial guarantee, an entity should determine whether that consideration arises from an exchange transaction and therefore represents a fair value. If the consideration does represent a fair value, the IPSASB concluded that entities should recognize the financial guarantee at the amount of the consideration and that subsequent measurement should be at the higher of the amount determined in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets* and the amount initially recognized, less, when appropriate, cumulative amortization recognized in accordance with IPSAS 9, *Revenue from Exchange Transactions*. Where the transaction price is not a fair value, an entity should be required to determine measurement at initial recognition in the same way as if no consideration had been paid.

BC18. The IPSASB therefore considered the approach to the determination of measurement at initial recognition for financial guarantee contracts provided for no consideration or for a consideration that is not a fair value. The IPSASB identified a valuation hierarchy that could be used in initially measuring a financial guarantee contract provided for no consideration or for consideration that is not a fair value:

- An entity assesses whether the fair value of the financial guarantee contract can be determined by observing a price in an active market;
- Where a price cannot be determined by observing a price in an active market, an entity uses a valuation technique; and
- If fair value cannot be determined for a financial guarantee contract, an entity measures a financial guarantee contract at initial recognition and subsequently in accordance with IPSAS 19.

BC19. There may be cases where an active market exists for financial guarantee contracts equivalent to or similar to that issued. In such cases a fair value should be estimated through observation of that active market. Where no active market exists, the IPSASB considered whether an entity should be required to move immediately to an approach based on IPSAS 19. The IPSASB noted that many valuation techniques are highly complex and, as noted in paragraphs AG107 and AG108 may give rise to a range of outcomes. It is arguable that the cost of developing such techniques exceeds the benefits to users of the information provided. An approach based on IPSAS 19 may provide a more reliable and understandable measure of an issuer's risk exposure as a result of entering into a financial guarantee contract. The IPSASB also acknowledged that where an entity does not recognize a liability in accordance with IPSAS 19, the entity makes the disclosures required for contingent liabilities in IPSAS 19 unless an outflow

of resources is remote. The information provided to users on risk exposure related to financial guarantees provided at nil or nominal consideration also includes the credit risk disclosures in IPSAS 30, *Financial Instruments: Disclosures*. Conversely, the IPSASB acknowledged that there are current IPSASs that require the use of experts, such as actuaries, to develop valuation techniques that are inherently complex, such as IPSAS 25, *Employee Benefits*. On balance the IPSASB concluded that, in the absence of an active market, entities should be permitted to use a valuation technique that does not rely on an observable market where they are satisfied that such a technique provides a reliable and understandable method of determining a fair value for a financial guarantee contract entered into by an issuer by means of a non-exchange transaction. This is particularly the case for non-standard guarantees where there is limited data available on defaults and credit risk.

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 29.

Section A: Scope

A.1 *Practice of Settling Net: Forward Contract to Purchase a Commodity*

Entity XYZ enters into a fixed price forward contract to purchase one million liters of oil in accordance with its expected usage requirements. The contract permits XYZ to take physical delivery of the oil at the end of twelve months or to pay or receive a net settlement in cash, based on the change in fair value of oil. Is the contract accounted for as a derivative?

While such a contract meets the definition of a derivative, it is not necessarily accounted for as a derivative. The contract is a derivative instrument because there is no initial net investment, the contract is based on the price of oil, and it is to be settled at a future date. However, if XYZ intends to settle the contract by taking delivery and has no history for similar contracts of settling net in cash or of taking delivery of the oil and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract is not accounted for as a derivative under IPSAS 29. Instead, it is accounted for as an executory contract.

A.2 *Option to Put a Non-Financial Asset*

Entity XYZ owns an office building. XYZ enters into a put option with an investor that permits XYZ to put the building to the investor for CU150 million. The current value of the building is CU175 million. The option expires in five years. The option, if exercised, may be settled through physical delivery or net cash, at XYZ's option. How do both XYZ and the investor account for the option?

XYZ's accounting depends on XYZ's intention and past practice for settlement. Although the contract meets the definition of a derivative, XYZ does not account for it as a derivative if XYZ intends to settle the contract by delivering the building if XYZ exercises its option and there is no past practice of settling net (IPSAS 29, paragraph 4 and IPSAS 29, paragraph AG22).

The investor, however, cannot conclude that the option was entered into to meet the investor's expected purchase, sale or usage requirements because the investor does not have the ability to require delivery (IPSAS 29, paragraph 6). In addition, the option may be settled net in cash. Therefore, the investor has to account for the contract as a derivative. Regardless of past practices, the investor's intention does not affect whether settlement is by delivery or in cash. The investor has written an option, and a written option in which the holder has a choice of physical settlement or net cash settlement can never satisfy the normal delivery requirement for the exemption from IPSAS 29 because the option writer does not have the ability to require delivery.

However, if the contract were a forward contract rather than an option, and if the contract required physical delivery and the reporting entity had no past practice of settling net in cash or of taking delivery of the building and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer's margin, the contract would not be accounted for as a derivative.

Section B: Definitions

B.1 *Definition of a Derivative: Examples of Derivatives and Underlyings*

What are examples of common derivative contracts and the identified underlying?

IPSAS 29 defines a derivative as follows:

A *derivative* is a financial instrument or other contract within the scope of this Standard with all three of the following characteristics:

- (a) **Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the “underlying”);**
- (b) **It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and**
- (c) **It is settled at a future date.**

Type of contract	Main pricing-settlement variable (underlying variable)
Interest rate swap	Interest rates
Currency swap (foreign exchange swap)	Currency rates
Commodity swap	Commodity prices
Equity swap	Equity prices (equity instruments of another entity)
Credit swap	Credit rating, credit index or credit price
Total return swap	Total fair value of the reference asset and interest rates
Purchased or written treasury bond option (call or put)	Interest rates
Purchased or written currency option (call or put)	Currency rates
Purchased or written commodity option (call or put)	Commodity prices
Purchased or written stock option (call or put)	Equity prices (equity instruments of another entity)

Type of contract	Main pricing-settlement variable (underlying variable)
Interest rate futures linked to government debt (treasury futures)	Interest rates
Currency futures	Currency rates
Commodity futures	Commodity prices
Interest rate forward linked to government debt (treasury forward)	Interest rates
Currency forward	Currency rates
Commodity forward	Commodity prices
Equity forward	Equity prices (equity instruments of another entity)

The above list provides examples of contracts that normally qualify as derivatives under IPSAS 29. The list is not exhaustive. Any contract that has an underlying may be a derivative. Moreover, even if an instrument meets the definition of a derivative contract, special provisions of IPSAS 29 may apply, for example, if it is a weather derivative (see IPSAS 29.AG5), a contract to buy or sell a non-financial item such as commodity (see IPSAS 29.4 and IPSAS 29.AG22) or a contract settled in an entity's own shares (see IPSAS 28.25–IPSAS 28.29). Therefore, an entity must evaluate the contract to determine whether the other characteristics of a derivative are present and whether special provisions apply.

B.2 *Definition of a Derivative: Settlement at a Future Date, Interest Rate Swap with Net or Gross Settlement*

For the purpose of determining whether an interest rate swap is a derivative financial instrument under IPSAS 29, does it make a difference whether the parties pay the interest payments to each other (gross settlement) or settle on a net basis?

No. The definition of a derivative does not depend on gross or net settlement.

To illustrate: Entity ABC enters into an interest rate swap with a counterparty (XYZ) that requires ABC to pay a fixed rate of 8 percent and receive a variable amount based on three-month LIBOR, reset on a quarterly basis. The fixed and variable amounts are determined based on a CU100 million notional amount. ABC and XYZ do not exchange the notional amount. ABC pays or receives a net cash amount each quarter based on the difference between 8 percent and three-month LIBOR. Alternatively, settlement may be on a gross basis.

The contract meets the definition of a derivative regardless of whether there is net or gross settlement because its value changes in response to changes in an underlying variable (LIBOR), there is no initial net investment, and settlements occur at future dates.

B.3 *Definition of a Derivative: Prepaid Interest Rate Swap (Fixed Rate Payment Obligation Prepaid at Inception or Subsequently)*

If a party prepays its obligation under a pay-fixed, receive-variable interest rate swap at inception, is the swap a derivative financial instrument?

Yes.

To illustrate: Entity S enters into a CU100 million notional amount five-year pay-fixed, receive-variable interest rate swap with Counterparty C. The interest rate of the variable part of the swap is reset on a quarterly basis to three-month LIBOR. The interest rate of the fixed part of the swap is 10 percent per year. Entity S prepays its fixed obligation under the swap of CU50 million ($\text{CU100 million} \times 10 \text{ percent} \times 5 \text{ years}$) at inception, discounted using market interest rates, while retaining the right to receive interest payments on the CU100 million reset quarterly based on three-month LIBOR over the life of the swap.

The initial net investment in the interest rate swap is significantly less than the notional amount on which the variable payments under the variable leg will be calculated. The contract requires an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, such as a variable rate bond. Therefore, the contract fulfills the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” provision of IPSAS 29. Even though Entity S has no future performance obligation, the ultimate settlement of the contract is at a future date and the value of the contract changes in response to changes in the LIBOR index. Accordingly, the contract is regarded as a derivative contract.

Would the answer change if the fixed rate payment obligation is prepaid subsequent to initial recognition?

If the fixed leg is prepaid during the term, that would be regarded as a termination of the old swap and an origination of a new instrument that is evaluated under IPSAS 29.

B.4 *Definition of a Derivative: Prepaid Pay-Variable, Receive-Fixed Interest Rate Swap*

If a party prepays its obligation under a pay-variable, receive-fixed interest rate swap at inception of the contract or subsequently, is the swap a derivative financial instrument?

No. A prepaid pay-variable, receive-fixed interest rate swap is not a derivative if it is prepaid at inception and it is no longer a derivative if it is prepaid after inception because it provides a return on the prepaid (invested) amount comparable to the return on a debt instrument with fixed cash flows. The prepaid amount fails the “no initial net investment or an initial net investment that is smaller than would be

required for other types of contracts that would be expected to have a similar response to changes in market factors” criterion of a derivative.

To illustrate: Entity S enters into a CU100 million notional amount five-year pay-variable, receive-fixed interest rate swap with Counterparty C. The variable leg of the swap is reset on a quarterly basis to three-month LIBOR. The fixed interest payments under the swap are calculated as 10 percent times the swap’s notional amount, i.e., CU10 million per year. Entity S prepays its obligation under the variable leg of the swap at inception at current market rates, while retaining the right to receive fixed interest payments of 10 percent on CU100 million per year.

The cash inflows under the contract are equivalent to those of a financial instrument with a fixed annuity stream since Entity S knows it will receive CU10 million per year over the life of the swap. Therefore, all else being equal, the initial investment in the contract should equal that of other financial instruments that consist of fixed annuities. Thus, the initial net investment in the pay-variable, receive-fixed interest rate swap is equal to the investment required in a non-derivative contract that has a similar response to changes in market conditions. For this reason, the instrument fails the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” criterion of IPSAS 29. Therefore, the contract is not accounted for as a derivative under IPSAS 29. By discharging the obligation to pay variable interest rate payments, Entity S in effect provides a loan to Counterparty C.

B.5 Definition of a Derivative: Offsetting Loans

Entity A makes a five-year fixed rate loan to Entity B, while B at the same time makes a five-year variable rate loan for the same amount to A. There are no transfers of principal at inception of the two loans, since A and B have a netting agreement. Is this a derivative under IPSAS 29?

Yes. This meets the definition of a derivative (that is to say, there is an underlying variable, no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and future settlement). The contractual effect of the loans is the equivalent of an interest rate swap arrangement with no initial net investment. Non-derivative transactions are aggregated and treated as a derivative when the transactions result, in substance, in a derivative. Indicators of this would include:

- They are entered into at the same time and in contemplation of one another;
- They have the same counterparty;
- They relate to the same risk; and

- There is no apparent economic need or substantive business purpose for structuring the transactions separately that could not also have been accomplished in a single transaction.

The same answer would apply if Entity A and Entity B did not have a netting agreement, because the definition of a derivative instrument in IPSAS 29.10 does not require net settlement.

B.6 *Definition of a Derivative: Option Not Expected to be Exercised*

The definition of a derivative in IPSAS 29.10 requires that the instrument “is settled at a future date.” Is this criterion met even if an option is expected not to be exercised, for example, because it is out of the money?

Yes. An option is settled upon exercise or at its maturity. Expiry at maturity is a form of settlement even though there is no additional exchange of consideration.

B.7 *Definition of a Derivative: Foreign Currency Contract Based on Sales Volume*

A South African entity, Entity XYZ, whose functional currency is the South African rand, sells electricity to Mozambique denominated in US dollars. XYZ enters into a contract with an investment bank to convert US dollars to rand at a fixed exchange rate. The contract requires XYZ to remit rand based on its sales volume in Mozambique in exchange for US dollars at a fixed exchange rate of 6.00. Is that contract a derivative?

Yes. The contract has two underlying variables (the foreign exchange rate and the volume of sales), no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and a payment provision. IPSAS 29 does not exclude from its scope derivatives that are based on sales volume.

B.8 *Definition of a Derivative: Prepaid Forward*

An entity enters into a forward contract to purchase shares of stock in one year at the forward price. It prepays at inception based on the current price of the shares. Is the forward contract a derivative?

No. The forward contract fails the “no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors” test for a derivative.

To illustrate: Entity XYZ enters into a forward contract to purchase one million T ordinary shares in one year. The current market price of T is CU50 per share; the one-year forward price of T is CU55 per share. XYZ is required to prepay the forward contract at inception with a CU50 million payment. The initial investment in the forward contract of CU50 million is less than the notional amount applied to the

underlying, one million shares at the forward price of CU55 per share, i.e., CU55 million. However, the initial net investment approximates the investment that would be required for other types of contracts that would be expected to have a similar response to changes in market factors because T's shares could be purchased at inception for the same price of CU50. Accordingly, the prepaid forward contract does not meet the initial net investment criterion of a derivative instrument.

B.9 Definition of a Derivative: Initial Net Investment

Many derivative instruments, such as futures contracts and exchange traded written options, require margin accounts. Is the margin account part of the initial net investment?

No. The margin account is not part of the initial net investment in a derivative instrument. Margin accounts are a form of collateral for the counterparty or clearing house and may take the form of cash, securities or other specified assets, typically liquid assets. Margin accounts are separate assets that are accounted for separately.

B.10 Definition of Held for Trading: Portfolio with a Recent Actual Pattern of Short-Term Profit-Taking

The definition of a financial asset or financial liability held for trading states that “a financial asset or financial liability is classified as held for trading if it is ... part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking.” What is a “portfolio” for the purposes of applying this definition?

Although the term “portfolio” is not explicitly defined in IPSAS 29, the context in which it is used suggests that a portfolio is a group of financial assets or financial liabilities that are managed as part of that group (IPSAS 29.10). If there is evidence of a recent actual pattern of short-term profit-taking on financial instruments included in such a portfolio, those financial instruments qualify as held for trading even though an individual financial instrument may in fact be held for a longer period of time.

B.11 Definition of Held for Trading: Balancing a Portfolio

Entity A has an investment portfolio of debt and equity instruments. The documented portfolio management guidelines specify that the equity exposure of the portfolio should be limited to between 30 and 50 percent of total portfolio value. The investment manager of the portfolio is authorized to balance the portfolio within the designated guidelines by buying and selling equity and debt instruments. Is Entity A permitted to classify the instruments as available for sale?

It depends on Entity A's intentions and past practice. If the portfolio manager is authorized to buy and sell instruments to balance the risks in a portfolio, but there is

no intention to trade and there is no past practice of trading for short-term profit, the instruments can be classified as available for sale. If the portfolio manager actively buys and sells instruments to generate short-term profits, the financial instruments in the portfolio are classified as held for trading.

B.12 *Definition of Held-to-Maturity Financial Assets: Index-Linked Principal*

Entity A purchases a five-year equity-index-linked note with an original issue price of CU10 at a market price of CU12 at the time of purchase. The note requires no interest payments before maturity. At maturity, the note requires payment of the original issue price of CU10 plus a supplemental redemption amount that depends on whether a specified share price index exceeds a predetermined level at the maturity date. If the share index does not exceed or is equal to the predetermined level, no supplemental redemption amount is paid. If the share index exceeds the predetermined level, the supplemental redemption amount equals the product of 1.15 and the difference between the level of the share index at maturity and the level of the share index when the note was issued divided by the level of the share index at the time of issue. Entity A has the positive intention and ability to hold the note to maturity. Can Entity A classify the note as a held-to-maturity investment?

Yes. The note can be classified as a held-to-maturity investment because it has a fixed payment of CU10 and fixed maturity and Entity A has the positive intention and ability to hold it to maturity (IPSAS 29.10). However, the equity index feature is a call option not closely related to the debt host, which must be separated as an embedded derivative under IPSAS 29.12. The purchase price of CU12 is allocated between the host debt instrument and the embedded derivative. For example, if the fair value of the embedded option at acquisition is CU4, the host debt instrument is measured at CU8 on initial recognition. In this case, the discount of CU2 that is implicit in the host bond (principal of CU10 minus the original carrying amount of CU8) is amortized to surplus or deficit over the term to maturity of the note using the effective interest method.

B.13 *Definition of Held-to-Maturity Financial Assets: Index-Linked Interest*

Can a bond with a fixed payment at maturity and a fixed maturity date be classified as a held-to-maturity investment if the bond's interest payments are indexed to the price of a commodity, and the entity has the positive intention and ability to hold the bond to maturity?

Yes. However, the commodity-indexed interest payments result in an embedded derivative that is separated and accounted for as a derivative at fair value (IPSAS 29.12). IPSAS 29.14 is not applicable since it should be straightforward to separate the host debt investment (the fixed payment at maturity) from the embedded derivative (the index-linked interest payments).

B.14 *Definition of Held-to-Maturity Financial Assets: Sale Following Rating Downgrade*

Would a sale of a held-to-maturity investment following a downgrade of the issuer's credit rating by a rating agency raise a question about the entity's intention to hold other investments to maturity?

Not necessarily. A downgrade is likely to indicate a decline in the issuer's creditworthiness. IPSAS 29 specifies that a sale due to a significant deterioration in the issuer's creditworthiness could satisfy the condition in IPSAS 29 and therefore not raise a question about the entity's intention to hold other investments to maturity. However, the deterioration in creditworthiness must be significant judged by reference to the credit rating at initial recognition. Also, the rating downgrade must not have been reasonably anticipated when the entity classified the investment as held to maturity in order to meet the condition in IPSAS 29. A credit downgrade of a notch within a class or from one rating class to the immediately lower rating class could often be regarded as reasonably anticipated. If the rating downgrade in combination with other information provides evidence of impairment, the deterioration in creditworthiness often would be regarded as significant.

B.15 *Definition of Held-to-Maturity Financial Assets: Permitted Sales*

Would sales of held-to-maturity financial assets due to a change in management compromise the classification of other financial assets as held to maturity?

Yes. A change in management is not identified under IPSAS 29.AG35 as an instance where sales or transfers from held-to-maturity do not compromise the classification as held to maturity. Sales in response to such a change in management would, therefore, call into question the entity's intention to hold investments to maturity.

To illustrate: Entity X has a portfolio of financial assets that is classified as held to maturity. In the current period, at the direction of the governing body, the senior management team has been replaced. The new management wishes to sell a portion of the held-to-maturity financial assets in order to carry out an expansion strategy designated and approved by the governing body. Although the previous management team had been in place since the entity's inception and Entity X had never before undergone a major restructuring, the sale nevertheless calls into question Entity X's intention to hold remaining held-to-maturity financial assets to maturity.

B.16 *Definition of Held-to-Maturity Investments: Sales in Response to Entity-Specific Capital Requirements*

In some countries, regulators of banks or other industries may set entity-specific capital requirements that are based on an assessment of the risk in that particular entity. IPSAS 29.AG35(e) indicates that an entity that sells held-to-maturity investments in response to an unanticipated significant increase by the regulator in the industry's capital requirements may do so under IPSAS 29 without necessarily raising a question about its intention to hold other

investments to maturity. Would sales of held-to-maturity investments that are due to a significant increase in entity-specific capital requirements imposed by regulators (i.e., capital requirements applicable to a particular entity, but not to the industry) raise such doubt?

Yes, such sales “taint” the entity’s intention to hold other financial assets as held to maturity unless it can be demonstrated that the sales fulfill the condition in IPSAS 29.10 in that they result from an increase in capital requirements, which is an isolated event that is beyond the entity’s control, is non-recurring and could not have been reasonably anticipated by the entity.

B.17 Definition of Held-to-Maturity Financial Assets: Pledged Collateral, Repurchase Agreements (repos), and Securities Lending Agreements

An entity cannot have a demonstrated ability to hold to maturity an investment if it is subject to a constraint that could frustrate its intention to hold the financial asset to maturity. Does this mean that a debt instrument that has been pledged as collateral, or transferred to another party under a repo or securities lending transaction, and continues to be recognized cannot be classified as a held-to-maturity investment?

No. An entity’s intention and ability to hold debt instruments to maturity is not necessarily constrained if those instruments have been pledged as collateral or are subject to a repurchase agreement or securities lending agreement. However, an entity does not have the positive intention and ability to hold the debt instruments until maturity if it does not expect to be able to maintain or recover access to the instruments.

B18. Definition of Held-to-Maturity Financial Assets: “Tainting”

In response to unsolicited tender offers, Entity A sells a significant amount of financial assets classified as held to maturity on economically favorable terms. Entity A does not classify any financial assets acquired after the date of the sale as held to maturity. However, it does not reclassify the remaining held-to-maturity investments since it maintains that it still intends to hold them to maturity. Is Entity A in compliance with IPSAS 29?

No. Whenever a sale or transfer of more than an insignificant amount of financial assets classified as held to maturity (HTM) results in the conditions in IPSAS 29.10 and IPSAS 29.AG35 not being satisfied, no instruments should be classified in that category. Accordingly, any remaining HTM assets are reclassified as available-for-sale financial assets. The reclassification is recorded in the reporting period in which the sales or transfers occurred and is accounted for as a change in classification under IPSAS 29.60. IPSAS 29.10 makes it clear that at least two full financial years must pass before an entity can again classify financial assets as HTM.

B.19 *Definition of Held-to-Maturity Investments: Sub-Categorization for the Purpose of Applying the “Tainting” Rule*

Can an entity apply the conditions for held-to-maturity classification in IPSAS 29.10 separately to different categories of held-to-maturity financial assets, such as debt instruments denominated in US dollars and debt instruments denominated in euro?

No. The “tainting rule” in IPSAS 29.10 is clear. If an entity has sold or reclassified more than an insignificant amount of held-to-maturity investments, it cannot classify any financial assets as held-to-maturity financial assets.

B.20 *Definition of Held-to-Maturity Investments: Application of the “Tainting” Rule on Consolidation*

Can an entity apply the conditions in IPSAS 29.10 separately to held-to-maturity financial assets held by different entities in an economic entity, for example, if separate entities are in different countries with different legal or economic environments?

No. If an entity has sold or reclassified more than an insignificant amount of investments classified as held-to-maturity in the consolidated financial statements, it cannot classify any financial assets as held-to-maturity financial assets in the consolidated financial statements unless the conditions in IPSAS 29.10 are met.

B.21 *Definition of Loans and Receivables: Equity Instrument*

Can an equity instrument, such as a preference share, with fixed or determinable payments be classified within loans and receivables by the holder?

Yes. If a non-derivative equity instrument would be recorded as a liability by the issuer, and it has fixed or determinable payments and is not quoted in an active market, it can be classified within loans and receivables by the holder, provided the definition is otherwise met. IPSAS 27.13–IPSAS 27.27 provide guidance about the classification of a financial instrument as a liability or as an equity instrument from the perspective of the issuer of a financial instrument. If an instrument meets the definition of an equity instrument under IPSAS 28, it cannot be classified within loans and receivables by the holder.

B.22 *Definition of Loans and Receivables: Banks’ Deposits in Other Banks*

Banks make term deposits with a central bank or other banks. Sometimes, the proof of deposit is negotiable, sometimes not. Even if negotiable, the depositor bank may or may not intend to sell it. Would such a deposit fall within loans and receivables under IPSAS 29.10?

Such a deposit meets the definition of loans and receivables, whether or not the proof of deposit is negotiable, unless the depositor bank intends to sell the instrument

immediately or in the near term, in which case the deposit is classified as a financial asset held for trading.

B.23 *Definition of Amortized Cost: Perpetual Debt Instruments with Fixed or Market-Based Variable Rate*

Sometimes entities purchase or issue debt instruments that are required to be measured at amortized cost and in respect of which the issuer has no obligation to repay the principal amount. Interest may be paid either at a fixed rate or at a variable rate. Would the difference between the initial amount paid or received and zero (“the maturity amount”) be amortized immediately on initial recognition for the purpose of determining amortized cost if the rate of interest is fixed or specified as a market-based variable rate?

No. Since there are no repayments of principal, there is no amortization of the difference between the initial amount and the maturity amount if the rate of interest is fixed or specified as a market-based variable rate. Because interest payments are fixed or market-based and will be paid in perpetuity, the amortized cost (the present value of the stream of future cash payments discounted at the effective interest rate) equals the principal amount in each period (IPSAS 29.10).

B.24 *Definition of Amortized Cost: Perpetual Debt Instruments with Decreasing Interest Rate*

If the stated rate of interest on a perpetual debt instrument decreases over time, would amortized cost equal the principal amount in each period?

No. From an economic perspective, some or all of the interest payments are repayments of the principal amount. For example, the interest rate may be stated as 16 percent for the first ten years and as zero percent in subsequent periods. In that case, the initial amount is amortized to zero over the first ten years using the effective interest method, since a portion of the interest payments represents repayments of the principal amount. The amortized cost is zero after year 10 because the present value of the stream of future cash payments in subsequent periods is zero (there are no further cash payments of either principal or interest in subsequent periods).

B.25 *Example of Calculating Amortized Cost: Financial Asset*

Financial assets that are excluded from fair valuation and have a fixed maturity should be measured at amortized cost. How is amortized cost calculated?

Under IPSAS 29, amortized cost is calculated using the effective interest method. The effective interest rate inherent in a financial instrument is the rate that exactly discounts the estimated cash flows associated with the financial instrument through the expected life of the instrument or, where appropriate, a shorter period to the net carrying amount at initial recognition. The computation includes all fees and points

paid or received that are an integral part of the effective interest rate, directly attributable transaction costs and all other premiums or discounts.

The following example illustrates how amortized cost is calculated using the effective interest method. Entity A purchases a debt instrument with five years remaining to maturity for its fair value of CU1,000 (including transaction costs). The instrument has a principal amount of CU1,250 and carries fixed interest of 4.7 percent that is paid annually ($\text{CU1,250} \times 4.7 \text{ percent} = \text{CU59}$ per year). The contract also specifies that the borrower has an option to prepay the instrument and that no penalty will be charged for prepayment. At inception, the entity expects the borrower not to prepay.

It can be shown that in order to allocate interest receipts and the initial discount over the term of the debt instrument at a constant rate on the carrying amount, they must be accrued at the rate of 10 percent annually. The table below provides information about the amortized cost, interest revenue and cash flows of the debt instrument in each reporting period.

Year	(a) (b = a × 10%)	(c)	(d = a + b – c)	
	Amortized cost at the beginning of the year	Interest revenue	Cash flows	Amortized cost at the end of the year
20X0	1,000	100	59	1,041
20X1	1,041	104	59	1,086
20X2	1,086	109	59	1,136
20X3	1,136	113	59	1,190
20X4	1,190	119	1,250 + 59	–

On the first day of 20X2 the entity revises its estimate of cash flows. It now expects that 50 percent of the principal will be prepaid at the end of 20X2 and the remaining 50 percent at the end of 20X4. In accordance with IPSAS 29.AG20, the opening balance of the debt instrument in 20X2 is adjusted. The adjusted amount is calculated by discounting the amount the entity expects to receive in 20X2 and subsequent years using the original effective interest rate (10 percent). This results in the new opening balance in 20X2 of CU1,138. The adjustment of CU52 ($\text{CU1,138} - \text{CU1,086}$) is recorded in surplus or deficit in 20X2. The table below provides information about the amortized cost, interest revenue and cash flows as they would be adjusted taking into account the change in estimate.

Year	(a) (b = a × 10%)	(c)	(d = a + b – c)
	Amortized cost at the beginning of the year	Interest revenue	Amortized cost at the end of the year
20X0	1,000	100	1,041
20X1	1,041	104	1,086
20X2	1,086 + 52	114	625 + 59
20X3	568	57	30
20X4	595	60	625 + 30

If the debt instrument becomes impaired, say, at the end of 20X3, the impairment loss is calculated as the difference between the carrying amount (CU595) and the present value of estimated future cash flows discounted at the original effective interest rate (10 percent).

B.26 *Example of Calculating Amortized Cost: Debt Instruments with Stepped Interest Payments*

Sometimes entities purchase or issue debt instruments with a predetermined rate of interest that increases or decreases progressively (“stepped interest”) over the term of the debt instrument. If a debt instrument with stepped interest and no embedded derivative is issued at CU1,250 and has a maturity amount of CU1,250, would the amortized cost equal CU1,250 in each reporting period over the term of the debt instrument?

No. Although there is no difference between the initial amount and maturity amount, an entity uses the effective interest method to allocate interest payments over the term of the debt instrument to achieve a constant rate on the carrying amount (IPSAS 29.10).

The following example illustrates how amortized cost is calculated using the effective interest method for an instrument with a predetermined rate of interest that increases or decreases over the term of the debt instrument (“stepped interest”).

On January 1, 2000, Entity A issues a debt instrument for a price of CU1,250. The principal amount is CU1,250 and the debt instrument is repayable on December 31, 2004. The rate of interest is specified in the debt agreement as a percentage of the principal amount as follows: 6.0 percent in 2000 (CU75), 8.0 percent in 2001 (CU100), 10.0 percent in 2002 (CU125), 12.0 percent in 2003 (CU150), and 16.4 percent in 2004 (CU205). In this case, the interest rate that exactly discounts the stream of future cash payments through maturity is 10 percent. Therefore, cash interest payments are reallocated over the term of the debt instrument for the purposes of determining amortized cost in each period. In each period, the amortized cost at the beginning of the period is multiplied by the effective interest rate of 10 percent and added to the amortized cost. Any cash payments in the period are

deducted from the resulting number. Accordingly, the amortized cost in each period is as follows:

Year	(a) (b = a × 10%)	(c)	(d = a + b - c)	
	Amortized cost at the beginning of the year	Interest revenue	Cash flows	Amortized cost at the end of the year
20X0	1,250	125	75	1,300
20X1	1,300	130	100	1,330
20X2	1,330	133	125	1,338
20X3	1,338	134	150	1,322
20X4	1,322	133	1,250 + 205	–

B.27 *Regular Way Contracts: No Established Market*

Can a contract to purchase a financial asset be a regular way contract if there is no established market for trading such a contract?

Yes. IPSAS 29.10 refers to terms that require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned. Marketplace, as that term is used in IPSAS 29.10, is not limited to a formal stock exchange or organized over-the-counter market. Rather, it means the environment in which the financial asset is customarily exchanged. An acceptable time frame would be the period reasonably and customarily required for the parties to complete the transaction and prepare and execute closing documents.

For example, a market for private issue financial instruments can be a marketplace.

B.28 *Regular Way Contracts: Forward Contract*

Entity ABC enters into a forward contract to purchase one million of M's ordinary shares in two months for CU10 per share. The contract is not an exchange-traded contract. The contract requires ABC to take physical delivery of the shares and pay the counterparty CU10 million in cash. M's shares trade in an active public market at an average of 100,000 shares a day. Regular way delivery is three days. Is the forward contract regarded as a regular way contract?

No. The contract must be accounted for as a derivative because it is not settled in the way established by regulation or convention in the marketplace concerned.

B.29 *Regular Way Contracts: Which Customary Settlement Provisions Apply?*

If an entity's financial instruments trade in more than one active market, and the settlement provisions differ in the various active markets, which provisions apply in assessing whether a contract to purchase those financial instruments is a regular way contract?

The provisions that apply are those in the market in which the purchase actually takes place.

To illustrate: Entity XYZ purchases one million shares of Entity ABC on a US stock exchange, for example, through a broker. The settlement date of the contract is six business days later. Trades for equity shares on US exchanges customarily settle in three business days. Because the trade settles in six business days, it does not meet the exemption as a regular way trade.

However, if XYZ did the same transaction on a foreign exchange that has a customary settlement period of six business days, the contract would meet the exemption for a regular way trade.

B.30 Regular Way Contracts: Share Purchase by Call Option

Entity A purchases a call option in a public market permitting it to purchase 100 shares of Entity XYZ at any time over the next three months at a price of CU100 per share. If Entity A exercises its option, it has 14 days to settle the transaction according to regulation or convention in the options market. XYZ shares are traded in an active public market that requires three-day settlement. Is the purchase of shares by exercising the option a regular way purchase of shares?

Yes. The settlement of an option is governed by regulation or convention in the marketplace for options and, therefore, upon exercise of the option it is no longer accounted for as a derivative because settlement by delivery of the shares within 14 days is a regular way transaction.

B.31 Recognition and Derecognition of Financial Liabilities Using Trade Date or Settlement Date Accounting

IPSAS 29 has special rules about recognition and derecognition of financial assets using trade date or settlement date accounting. Do these rules apply to transactions in financial instruments that are classified as financial liabilities, such as transactions in deposit liabilities and trading liabilities?

No. IPSAS 29 does not contain any specific requirements about trade date accounting and settlement date accounting in the case of transactions in financial instruments that are classified as financial liabilities. Therefore, the general recognition and derecognition requirements in IPSAS 29.18 and IPSAS 29.41 apply. IPSAS 29.16 states that financial liabilities are recognized on the date the entity “becomes a party to the contractual provisions of the instrument.” Such contracts generally are not recognized unless one of the parties has performed or the contract is a derivative contract not exempted from the scope of IPSAS 29. IPSAS 29.41 specifies that financial liabilities are derecognized only when they are extinguished, i.e., when the obligation specified in the contract is discharged or cancelled or expires.

Section C: Embedded Derivatives

C.1 *Embedded Derivatives: Separation of Host Debt Instrument*

If an embedded non-option derivative is required to be separated from a host debt instrument, how are the terms of the host debt instrument and the embedded derivative identified? For example, would the host debt instrument be a fixed rate instrument, a variable rate instrument or a zero coupon instrument?

The terms of the host debt instrument reflect the stated or implied substantive terms of the hybrid instrument. In the absence of implied or stated terms, the entity makes its own judgment of the terms. However, an entity may not identify a component that is not specified or may not establish terms of the host debt instrument in a manner that would result in the separation of an embedded derivative that is not already clearly present in the hybrid instrument, that is to say, it cannot create a cash flow that does not exist. For example, if a five-year debt instrument has fixed interest payments of CU40,000 annually and a principal payment at maturity of CU1,000,000 multiplied by the change in an equity price index, it would be inappropriate to identify a floating rate host contract and an embedded equity swap that has an offsetting floating rate leg in lieu of identifying a fixed rate host. In that example, the host contract is a fixed rate debt instrument that pays CU40,000 annually because there are no floating interest rate cash flows in the hybrid instrument.

In addition, the terms of an embedded non-option derivative, such as a forward or swap, must be determined so as to result in the embedded derivative having a fair value of zero at the inception of the hybrid instrument. If it were permitted to separate embedded non-option derivatives on other terms, a single hybrid instrument could be decomposed into an infinite variety of combinations of host debt instruments and embedded derivatives, for example, by separating embedded derivatives with terms that create leverage, asymmetry or some other risk exposure not already present in the hybrid instrument. Therefore, it is inappropriate to separate an embedded non-option derivative on terms that result in a fair value other than zero at the inception of the hybrid instrument. The determination of the terms of the embedded derivative is based on the conditions existing when the financial instrument was issued.

C.2 *Embedded Derivatives: Separation of Embedded Option*

The response to Question C.1 states that the terms of an embedded non-option derivative should be determined so as to result in the embedded derivative having a fair value of zero at the initial recognition of the hybrid instrument. When an embedded option-based derivative is separated, must the terms of the embedded option be determined so as to result in the embedded derivative having either a fair value of zero or an intrinsic value of zero (that is to say, be at the money) at the inception of the hybrid instrument?

No. The economic behavior of a hybrid instrument with an option-based embedded derivative depends critically on the strike price (or strike rate) specified for the option feature in the hybrid instrument, as discussed below. Therefore, the separation of an option-based embedded derivative (including any embedded put, call, cap, floor, capton, floortion or swaption feature in a hybrid instrument) should be based on the stated terms of the option feature documented in the hybrid instrument. As a result, the embedded derivative would not necessarily have a fair value or intrinsic value equal to zero at the initial recognition of the hybrid instrument.

If an entity were required to identify the terms of an embedded option-based derivative so as to achieve a fair value of the embedded derivative of zero, the strike price (or strike rate) generally would have to be determined so as to result in the option being infinitely out of the money. This would imply a zero probability of the option feature being exercised. However, since the probability of the option feature in a hybrid instrument being exercised generally is not zero, it would be inconsistent with the likely economic behavior of the hybrid instrument to assume an initial fair value of zero. Similarly, if an entity were required to identify the terms of an embedded option-based derivative so as to achieve an intrinsic value of zero for the embedded derivative, the strike price (or strike rate) would have to be assumed to equal the price (or rate) of the underlying variable at the initial recognition of the hybrid instrument. In this case, the fair value of the option would consist only of time value. However, such an assumption would not be consistent with the likely economic behavior of the hybrid instrument, including the probability of the option feature being exercised, unless the agreed strike price was indeed equal to the price (or rate) of the underlying variable at the initial recognition of the hybrid instrument.

The economic nature of an option-based embedded derivative is fundamentally different from a forward-based embedded derivative (including forwards and swaps), because the terms of a forward are such that a payment based on the difference between the price of the underlying and the forward price will occur at a specified date, while the terms of an option are such that a payment based on the difference between the price of the underlying and the strike price of the option may or may not occur depending on the relationship between the agreed strike price and the price of the underlying at a specified date or dates in the future. Adjusting the strike price of an option-based embedded derivative, therefore, alters the nature of the hybrid instrument. On the other hand, if the terms of a non-option embedded derivative in a host debt instrument were determined so as to result in a fair value of any amount other than zero at the inception of the hybrid instrument, that amount would essentially represent a borrowing or lending. Accordingly, as discussed in the answer to Question C.1, it is not appropriate to separate a non-option embedded derivative in a host debt instrument on terms that result in a fair value other than zero at the initial recognition of the hybrid instrument.

C.3 *Embedded Derivatives: Accounting for a Convertible Bond*

What is the accounting treatment of an investment in a bond (financial asset) that is convertible into equity instruments of the issuing entity or another entity before maturity?

An investment in a convertible bond that is convertible before maturity generally cannot be classified as a held-to-maturity investment because that would be inconsistent with paying for the conversion feature – the right to convert into equity instruments before maturity.

An investment in a convertible bond can be classified as an available-for-sale financial asset provided it is not purchased for trading purposes. The equity conversion option is an embedded derivative.

If the bond is classified as available for sale (i.e., fair value changes recognized in net assets/equity until the bond is sold), the equity conversion option (the embedded derivative) is separated. The amount paid for the bond is split between the debt instrument without the conversion option and the equity conversion option. Changes in the fair value of the equity conversion option are recognized in surplus or deficit unless the option is part of a cash flow hedging relationship.

If the convertible bond is measured at fair value with changes in fair value recognized in surplus or deficit, separating the embedded derivative from the host bond is not permitted.

C.4 *Embedded Derivatives: Equity Kicker*

In some instances, venture capital entities providing subordinated loans agree that if and when the borrower lists its shares on a stock exchange, the venture capital entity is entitled to receive shares of the borrowing entity free of charge or at a very low price (an “equity kicker”) in addition to interest and repayment of principal. As a result of the equity kicker feature, the interest on the subordinated loan is lower than it would otherwise be. Assuming that the subordinated loan is not measured at fair value with changes in fair value recognized in surplus or deficit (IPSAS 29.12(c)), does the equity kicker feature meet the definition of an embedded derivative even though it is contingent upon the future listing of the borrower?

Yes. The economic characteristics and risks of an equity return are not closely related to the economic characteristics and risks of a host debt instrument (IPSAS 29.12(a)). The equity kicker meets the definition of a derivative because it has a value that changes in response to the change in the price of the shares of the borrower, it requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors, and it is settled at a future date (IPSAS 29.12(b) and IPSAS 29.10(a)). The equity kicker feature meets the definition of a derivative even though the right to receive shares is contingent upon the future

listing of the borrower. IPSAS 29.AG21 states that a derivative could require a payment as a result of some future event that is unrelated to a notional amount. An equity kicker feature is similar to such a derivative except that it does not give a right to a fixed payment, but an option right, if the future event occurs.

C.5 Embedded Derivatives: Identifying Debt or Equity Instruments as Host Contracts

Entity A purchases a five-year “debt” instrument issued by Entity B with a principal amount of CU1 million that is indexed to the share price of Entity C. At maturity, Entity A will receive from Entity B the principal amount plus or minus the change in the fair value of 10,000 shares of Entity C. The current share price is CU110. No separate interest payments are made by Entity B. The purchase price is CU1 million. Entity A classifies the debt instrument as available for sale. Entity A concludes that the instrument is a hybrid instrument with an embedded derivative because of the equity-indexed principal. For the purposes of separating an embedded derivative, is the host contract an equity instrument or a debt instrument?

The host contract is a debt instrument because the hybrid instrument has a stated maturity, i.e., it does not meet the definition of an equity instrument (IPSAS 28.9 and IPSAS 28.14). It is accounted for as a zero coupon debt instrument. Thus, in accounting for the host instrument, Entity A imputes interest on CU1 million over five years using the applicable market interest rate at initial recognition. The embedded non-option derivative is separated so as to have an initial fair value of zero (see Question C.1).

C.6 Embedded Derivatives: Synthetic Instruments

Entity A acquires a five-year floating rate debt instrument issued by Entity B. At the same time, it enters into a five-year pay-variable, receive-fixed interest rate swap with Entity C. Entity A regards the combination of the debt instrument and swap as a synthetic fixed rate instrument and classifies the instrument as a held-to-maturity investment, since it has the positive intention and ability to hold it to maturity. Entity A contends that separate accounting for the swap is inappropriate since IPSAS 29.AG46(a) requires an embedded derivative to be classified together with its host instrument if the derivative is linked to an interest rate that can change the amount of interest that would otherwise be paid or received on the host debt contract. Is the entity’s analysis correct?

No. Embedded derivative instruments are terms and conditions that are included in non-derivative host contracts. It is generally inappropriate to treat two or more separate financial instruments as a single combined instrument (“synthetic instrument” accounting) for the purpose of applying IPSAS 29. Each of the financial instruments has its own terms and conditions and each may be transferred or settled separately. Therefore, the debt instrument and the swap are classified separately. The

transactions described here differ from the transactions discussed in Question B.5, which had no substance apart from the resulting interest rate swap.

C.7 Embedded Derivatives: Purchases and Sales Contracts in Foreign Currency Instruments

A supply contract provides for payment in a currency other than (a) the functional currency of either party to the contract, (b) the currency in which the product is routinely denominated in commercial transactions around the world, and (c) the currency that is commonly used in contracts to purchase or sell non-financial items in the economic environment in which the transaction takes place. Is there an embedded derivative that should be separated under IPSAS 29?

Yes. To illustrate: a Norwegian entity agrees to sell oil to an entity in France. The oil contract is denominated in Swiss francs, although oil contracts are routinely denominated in US dollars in commercial transactions around the world, and Norwegian krone are commonly used in contracts to purchase or sell non-financial items in Norway. Neither entity carries out any significant activities in Swiss francs. In this case, the Norwegian entity regards the supply contract as a host contract with an embedded foreign currency forward to purchase Swiss francs. The French entity regards the supply contract as a host contract with an embedded foreign currency forward to sell Swiss francs. Each entity includes fair value changes on the currency forward in surplus or deficit unless the reporting entity designates it as a cash flow hedging instrument, if appropriate.

C.8 Embedded Foreign Currency Derivatives: Unrelated Foreign Currency Provision

Entity A, which measures items in its financial statements on the basis of the euro (its functional currency), enters into a contract with Entity B, which has the Norwegian krone as its functional currency, to purchase oil in six months for 1,000 US dollars. The host oil contract is not within the scope of IPSAS 29 because it was entered into and continues to be for the purpose of delivery of a non-financial item in accordance with the entity's expected purchase, sale or usage requirements (IPSAS 29.4 and IPSAS 29.AG22). The oil contract includes a leveraged foreign exchange provision that states that the parties, in addition to the provision of, and payment for, oil will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars. Under IPSAS 29.12, is that embedded derivative (the leveraged foreign exchange provision) regarded as closely related to the host oil contract?

No, that leveraged foreign exchange provision is separated from the host oil contract because it is not closely related to the host oil contract (IPSAS 29.AG46(d)).

The payment provision under the host oil contract of 1,000 US dollars can be viewed as a foreign currency derivative because the US dollar is neither Entity A's nor

Entity B's functional currency. This foreign currency derivative would not be separated because it follows from IPSAS 29.AG45(d) that a crude oil contract that requires payment in US dollars is not regarded as a host contract with a foreign currency derivative.

The leveraged foreign exchange provision that states that the parties will exchange an amount equal to the fluctuation in the exchange rate of the US dollar and Norwegian krone applied to a notional amount of 100,000 US dollars is in addition to the required payment for the oil transaction. It is unrelated to the host oil contract and therefore separated from the host oil contract and accounted for as an embedded derivative under IPSAS 29.12.

C.9 *Embedded Foreign Currency Derivatives: Currency of International Commerce*

IPSAS 29.AG46(d) refers to the currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world. Could it be a currency that is used for a certain product or service in commercial transactions within the local area of one of the substantial parties to the contract?

No. The currency in which the price of the related goods or services is routinely denominated in commercial transactions around the world is only a currency that is used for similar transactions all around the world, not just in one local area. For example, if cross-border transactions in natural gas in North America are routinely denominated in US dollars and such transactions are routinely denominated in euro in Europe, neither the US dollar nor the euro is a currency in which the goods or services are routinely denominated in commercial transactions around the world.

C.10 *Embedded Derivatives: Holder Permitted, But Not Required, to Settle Without Recovering Substantially all of its Recognized Investment*

If the terms of a combined instrument permit, but do not require, the holder to settle the combined instrument in a manner that causes it not to recover substantially all of its recognized investment and the issuer does not have such a right (e.g., a puttable debt instrument), does the contract satisfy the condition in IPSAS 29.AG46(a) that the holder would not recover substantially all of its recognized investment?

No. The condition that “the holder would not recover substantially all of its recognized investment” is not satisfied if the terms of the combined instrument permit, but do not require, the investor to settle the combined instrument in a manner that causes it not to recover substantially all of its recognized investment and the issuer has no such right. Accordingly, an interest-bearing host contract with an embedded interest rate derivative with such terms is regarded as closely related to the host contract. The condition that “the holder would not recover substantially all of its recognized investment” applies to situations in which the holder can be forced to

accept settlement at an amount that causes the holder not to recover substantially all of its recognized investment.

C.11 Embedded Derivatives: Reliable Determination of Fair Value

If an embedded derivative that is required to be separated cannot be reliably measured because it will be settled by an unquoted equity instrument whose fair value cannot be reliably measured, is the embedded derivative measured at cost?

No. In this case, the entire combined contract is treated as a financial instrument held for trading (IPSAS 29.14). If the fair value of the combined instrument can be reliably measured, the combined contract is measured at fair value. The entity might conclude, however, that the equity component of the combined instrument may be sufficiently significant to preclude it from obtaining a reliable estimate of the entire instrument. In that case, the combined instrument is measured at cost less impairment.

Section D: Recognition and Derecognition

D.1 Initial Recognition

D.1.1 Recognition: Cash Collateral

Entity B transfers cash to Entity A as collateral for another transaction with Entity A (e.g., a securities borrowing transaction). The cash is not legally segregated from Entity A's assets. Should Entity A recognize the cash collateral it has received as an asset?

Yes. The ultimate realization of a financial asset is its conversion into cash and, therefore, no further transformation is required before the economic benefits of the cash transferred by Entity B can be realized by Entity A. Therefore, Entity A recognizes the cash as an asset and a payable to Entity B while Entity B derecognizes the cash and recognizes a receivable from Entity A.

D.2 Regular Way Purchase or Sale of a Financial Asset

D.2.1 Trade Date vs. Settlement Date: Amounts to be Recorded for a Purchase

How are the trade date and settlement date accounting principles in the Standard applied to a purchase of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in the Standard for a purchase of a financial asset. On December 29, 20X1, an entity commits itself to purchase a financial asset for CU1,000, which is its fair value on commitment (trade) date. Transaction costs are immaterial. On December 31, 20X1 (financial year-end) and on January 4, 20X2 (settlement date) the fair value of the asset is CU1,002 and CU1,003, respectively. The amounts to be recorded for the asset will depend on how it is classified and

whether trade date or settlement date accounting is used, as shown in the two tables below.

Settlement Date Accounting			
Balances	Held-to-maturity investments carried at amortized cost	Available-for-sale assets remeasured to fair value with changes in net assets/equity	Assets at fair value through surplus or deficit remeasured to fair value with changes in surplus or deficit
December 29, 20X1			
Financial asset	—	—	—
Financial liability	—	—	—
December 31, 20X1			
Receivable	—	2	2
Financial asset	—	—	—
Financial liability	—	—	—
Net assets/equity (fair value adjustment)	—	(2)	—
Accumulated surplus or deficit (through surplus or deficit)	—	—	(2)
January 4, 20X2			
Receivable	—	—	—
Financial asset	1,000	1,003	1,003
Financial liability	—	—	—
Net assets/equity (fair value adjustment)	—	(3)	—
Accumulated surplus or deficit (through surplus or deficit)	—	—	(3)

Trade Date Accounting			
Balances	Held-to-maturity investments carried at amortized cost	Available-for-sale assets remeasured to fair value with changes in net assets/equity	Assets at fair value through surplus or deficit remeasured to fair value with changes in surplus or deficit
December 29, 20X1			
Financial asset	1,000	1,000	1,000
Financial liability	(1,000)	(1,000)	(1,000)
December 31, 20X1			
Receivable	–	–	–
Financial asset	1,000	1,002	1,002
Financial liability	(1,000)	(1,000)	(1,000)
Net assets/equity (fair value adjustment)	–	(2)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(2)
January 4, 20X2			
Receivable	–	–	–
Financial asset	1,000	1,003	1,003
Financial liability	–	–	–
Net assets/equity (fair value adjustment)	–	(3)	–
Accumulated surplus or deficit (through surplus or deficit)	–	–	(3)

D.2.2 Trade Date vs. Settlement Date: Amounts to be Recorded for a Sale

How are the trade date and settlement date accounting principles in the Standard applied to a sale of a financial asset?

The following example illustrates the application of the trade date and settlement date accounting principles in the Standard for a sale of a financial asset. On December 29, 20X2 (trade date) an entity enters into a contract to sell a financial asset for its current fair value of CU1,010. The asset was acquired one year earlier for CU1,000 and its amortized cost is CU1,000. On December 31, 20X2 (financial year-end), the fair value of the asset is CU1,012. On January 4, 20X3 (settlement date), the fair value is CU1,013. The amounts to be recorded will depend on how the

asset is classified and whether trade date or settlement date accounting is used as shown in the two tables below (any interest that might have accrued on the asset is disregarded).

A change in the fair value of a financial asset that is sold on a regular way basis is not recorded in the financial statements between trade date and settlement date even if the entity applies settlement date accounting because the seller's right to changes in the fair value ceases on the trade date.

Settlement Date Accounting			
Balances	Held-to-maturity investments carried at amortized cost	Available-for-sale assets remeasured to fair value with changes in net assets/equity	Assets at fair value through surplus or deficit remeasured to fair value with changes in surplus or deficit
December 29, 20X2			
Receivable	—	—	—
Financial asset	1,000	1,010	1,010
Net assets/equity (fair value adjustment)	—	10	—
Accumulated surplus or deficit (through surplus or deficit)	—	—	10
December 31, 20X2			
Receivable	—	—	—
Financial asset	1,000	1,010	1,010
Net assets/equity (fair value adjustment)	—	10	—
Accumulated surplus or deficit (through surplus or deficit)	—	—	10
January 4, 20X3			
Net assets/equity (fair value adjustment)	—	—	—
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

Trade Date Accounting			
Balances	Held-to-maturity investments carried at amortized cost	Available-for-sale assets remeasured to fair value with changes in net assets/equity	Assets at fair value through surplus or deficit remeasured to fair value with changes in surplus or deficit
December 29, 20X2			
Receivable	1,010	1,010	1,010
Financial asset	—	—	—
Equity (fair value adjustment)	—	—	—
Accumulated surplus or deficit (through surplus or deficit)	10	10	10
December 31, 20X2			
Receivable	1,010	1,010	1,010
Financial asset	—	—	—
Net assets/equity (fair value adjustment)	—	—	—
Accumulated surplus or deficit (through surplus or deficit)	10	10	10
January 4, 20X3			
Net assets/equity (fair value adjustment)	—	—	—
Accumulated surplus or deficit (through surplus or deficit)	10	10	10

D.2.3 Settlement Date Accounting: Exchange of Non-Cash Financial Assets

If an entity recognizes sales of financial assets using settlement date accounting, would a change in the fair value of a financial asset to be received in exchange for the non-cash financial asset that is sold be recognized in accordance with IPSAS 29.66?

It depends. Any change in the fair value of the financial asset to be received would be accounted for under IPSAS 29.66 if the entity applies settlement date accounting for that category of financial assets. However, if the entity classifies the financial asset to be received in a category for which it applies trade date accounting, the asset

to be received is recognized on the trade date as described in IPSAS 29.AG70. In that case, the entity recognizes a liability of an amount equal to the carrying amount of the financial asset to be delivered on settlement date.

To illustrate: on December 29, 20X2 (trade date) Entity A enters into a contract to sell Note Receivable A, which is carried at amortized cost, in exchange for Bond B, which will be classified as held for trading and measured at fair value. Both assets have a fair value of CU1,010 on December, 29, while the amortized cost of Note Receivable A is CU1,000. Entity A uses settlement date accounting for loans and receivables and trade date accounting for assets held for trading. On December 31, 20X2 (financial year-end), the fair value of Note Receivable A is CU1,012 and the fair value of Bond B is CU1,009. On January, 4 20X3, the fair value of Note Receivable A is CU1,013 and the fair value of Bond B is CU1,007. The following entries are made:

December 29, 20X2

Dr	Bond B	CU1,010	
	Cr Payable		CU1,010

December 31, 20X2

Dr	Trading loss	CU1	
	Cr Bond B		CU1

January 4, 20X3

Dr	Payable	CU1,010	
Dr	Trading loss	CU2	
	Cr Note Receivable A		CU1,000
	Cr Bond B		CU2
	Cr Realization gain		CU10

Section E: Measurement

E.1 *Initial Measurement of Financial Assets and Financial Liabilities*

E.1.1 **Initial Measurement: Transaction Costs**

Transaction costs should be included in the initial measurement of financial assets and financial liabilities other than those at fair value through surplus or deficit. How should this requirement be applied in practice?

For financial assets, incremental costs that are directly attributable to the acquisition of the asset, for example fees and commissions, are added to the amount originally recognized. For financial liabilities, directly related costs of issuing debt are deducted from the amount of debt originally recognized. For financial instruments that are measured at fair value through surplus or deficit, transaction costs are not added to the fair value measurement at initial recognition.

For financial instruments that are carried at amortized cost, such as held-to-maturity investments, loans and receivables, and financial liabilities that are not at fair value through surplus or deficit, transaction costs are included in the calculation of amortized cost using the effective interest method and, in effect, amortized through surplus or deficit over the life of the instrument.

For available-for-sale financial assets, transaction costs are recognized in other net assets/equity as part of a change in fair value at the next remeasurement. If an available-for-sale financial asset has fixed or determinable payments and does not have an indefinite life, the transaction costs are amortized to surplus or deficit using the effective interest method. If an available-for-sale financial asset does not have fixed or determinable payments and has an indefinite life, the transaction costs are recognized in surplus or deficit when the asset is derecognized or becomes impaired.

Transaction costs expected to be incurred on transfer or disposal of a financial instrument are not included in the measurement of the financial instrument.

E.2 Fair Value Measurement Considerations

E.2.1 Fair Value Measurement Considerations for Investment Funds

IPSAS 29.AG104 states that the current bid price is usually the appropriate price to be used in measuring the fair value of an asset held. The rules applicable to some investment funds require net asset values to be reported to investors on the basis of mid-market prices. In these circumstances, would it be appropriate for an investment fund to measure its assets on the basis of mid-market prices?

No. The existence of regulations that require a different measurement for specific purposes does not justify a departure from the general requirement in IPSAS 29.AG104 to use the current bid price in the absence of a matching liability position. In its financial statements, an investment fund measures its assets at current bid prices. In reporting its net asset value to investors, an investment fund may wish to provide a reconciliation between the fair values recognized in its statement of financial position and the prices used for the net asset value calculation.

E.2.2 Fair Value Measurement: Large Holding

Entity A holds 15 percent of the share capital in Entity B. The shares are publicly traded in an active market. The currently quoted price is CU100. Daily trading volume is 0.1 percent of outstanding shares. Because Entity A believes that the fair value of the Entity B shares it owns, if sold as a block, is greater than the quoted market price, Entity A obtains several independent estimates of the price it would obtain if it sells its holding. These estimates indicate that Entity A would be able to obtain a price of CU105, i.e., a 5 percent premium above the quoted price. Which figure should Entity A use for measuring its holding at fair value?

Under IPSAS 29.AG103, a published price quotation in an active market is the best estimate of fair value. Therefore, Entity A uses the published price quotation (CU100). Entity A cannot depart from the quoted market price solely because independent estimates indicate that Entity A would obtain a higher (or lower) price by selling the holding as a block.

E.3 *Gains and Losses*

E.3.1 **Available-For-Sale Financial Assets: Exchange of Shares**

Entity A holds a small number of shares in Entity B. The shares are classified as available for sale. On December 20, 20X0, the fair value of the shares is CU120 and the cumulative gain recognized in net assets/equity is CU20. On the same day, Entity B is acquired by Entity C. As a result, Entity A receives shares in Entity C in exchange for those it had in Entity B of equal fair value. Under IPSAS 29.64(b), should Entity A reclassify the cumulative gain of CU20 recognized in net assets/equity to surplus or deficit?

Yes. The transaction qualifies for derecognition under IPSAS 29. IPSAS 29.64(b) requires the cumulative gain or loss on an available-for-sale financial asset that has been recognized in net assets/equity to be recognized in surplus or deficit when the asset is derecognized. In the exchange of shares, Entity A disposes of the shares it had in Entity B and receives shares in Entity C.

E.3.2 **IPSAS 29 and IPSAS 4 Available-For-Sale Financial Assets: Separation of Currency Component**

For an available-for-sale monetary financial asset, the entity recognizes changes in the carrying amount relating to changes in foreign exchange rates in surplus or deficit in accordance with IPSAS 4.27(a) and IPSAS 4.32 and other changes in the carrying amount in net assets/equity in accordance with IPSAS 29. How is the cumulative gain or loss that is recognized in net assets/equity determined?

It is the difference between the amortized cost (adjusted for impairment, if any) and fair value of the available-for-sale monetary financial asset in the functional currency of the reporting entity. For the purpose of applying IPSAS 4.32 the asset is treated as an asset measured at amortized cost in the foreign currency.

To illustrate: on December 31, 20X1 Entity A acquires a bond denominated in a foreign currency (FC) for its fair value of FC1,000. The bond has five years remaining to maturity and a principal amount of FC1,250, carries fixed interest of 4.7 percent that is paid annually ($FC1,250 \times 4.7 \text{ percent} = FC59$ per year), and has an effective interest rate of 10 percent. Entity A classifies the bond as available for sale, and thus recognizes gains and losses in net assets/equity. The entity's functional currency is its local currency (LC). The exchange rate is FC1 to LC1.5 and the carrying amount of the bond is LC1,500 ($= FC1,000 \times 1.5$).

Dr	Bond	LC1,500	
	Cr	Cash	LC1,500

On December 31, 20X2, the foreign currency has appreciated and the exchange rate is FC1 to LC2. The fair value of the bond is FC1,060 and thus the carrying amount is LC2,120 ($= \text{FC1,060} \times 2$). The amortized cost is FC1,041 ($= \text{LC2,082}$). In this case, the cumulative gain or loss to be recognized and accumulated in net assets/equity is the difference between the fair value and the amortized cost on December 31, 20X2, i.e., LC38 ($= \text{LC2,120} - \text{LC2,082}$).

Interest received on the bond on December 31, 20X2 is FC59 ($= \text{LC118}$). Interest revenue determined in accordance with the effective interest method is FC100 ($= 1,000 \times 10$ percent). The average exchange rate during the year is FC1 to LC1.75. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest revenue during the year (IPSAS 4.25). Thus, reported interest revenue is LC175 ($= \text{FC100} \times 1.75$) including accretion of the initial discount of LC72 ($= [\text{FC100} - \text{FC59}] \times 1.75$). Accordingly, the exchange difference on the bond that is recognized in surplus or deficit is LC510 ($= \text{LC2,082} - \text{LC1,500} - \text{LC72}$). Also, there is an exchange gain on the interest receivable for the year of LC15 ($= \text{FC59} \times [2.00 - 1.75]$).

Dr	Bond	LC620	
Dr	Cash	LC118	
Cr	Interest revenue		LC175
Cr	Exchange gain		LC525
Cr	Fair value change in net assets/equity		LC38

On December 31, 20X3, the foreign currency has appreciated further and the exchange rate is FC1 to LC2.50. The fair value of the bond is FC1,070 and thus the carrying amount is LC2,675 ($= \text{FC1,070} \times 2.50$). The amortized cost is FC1,086 ($= \text{LC2,715}$). The cumulative gain or loss to be accumulated in net assets/equity is the difference between the fair value and the amortized cost on December 31, 20X3, i.e., negative LC40 ($= \text{LC2,675} - \text{LC2,715}$). Thus, the amount recognized in net assets/equity equals the change in the difference during 20X3 of LC78 ($= \text{LC40} + \text{LC38}$).

Interest received on the bond on December 31, 20X3 is FC59 ($= \text{LC148}$). Interest revenue determined in accordance with the effective interest method is FC104 ($= \text{FC1,041} \times 10$ percent). The average exchange rate during the year is FC1 to LC2.25. For the purpose of this question, it is assumed that the use of the average exchange rate provides a reliable approximation of the spot rates applicable to the accrual of interest revenue during the year (IPSAS 4.25). Thus, recognized interest revenue is LC234 ($= \text{FC104} \times 2.25$) including accretion of the initial discount of LC101 ($= [\text{FC104} - \text{FC59}] \times 2.25$). Accordingly, the exchange difference on the bond that is recognized in surplus or deficit is LC532 ($= \text{LC2,715} - \text{LC2,082} - \text{LC101}$). Also, there is an exchange gain on the interest receivable for the year of LC15 ($= \text{FC59} \times [2.50 - 2.25]$).

Dr	Bond	LC555	
Dr	Cash	LC148	
Dr	Fair value change in net assets/equity	LC78	
	Cr	Interest revenue	LC234
	Cr	Exchange gain	LC547

E.3.3 **IPSAS 29 and IPSAS 4 Exchange Differences Arising on Translation of Foreign Entities: Net Assets/Equity or, Surplus or Deficit?**

IPSAS 4.37 and IPSAS 4.57 states that all exchange differences resulting from translating the financial statements of a foreign operation should be recognized in net assets/equity until disposal of the net investment. This would include exchange differences arising from financial instruments carried at fair value, which would include both financial assets classified as at fair value through surplus or deficit and financial assets that are available for sale.

IPSAS 29.64 requires that changes in fair value of financial assets classified as at fair value through surplus or deficit should be recognized in surplus or deficit and changes in fair value of available-for-sale investments should be recognized in net assets/equity.

If the foreign operation is a controlled entity whose financial statements are consolidated with those of its controlling entity, in the consolidated financial statements how are IPSAS 29.64 and IPSAS 4.44 applied?

IPSAS 29 applies in the accounting for financial instruments in the financial statements of a foreign operation and IPSAS 4 applies in translating the financial statements of a foreign operation for incorporation in the financial statements of the reporting entity.

To illustrate: Entity A is domiciled in Country X and its functional currency and presentation currency are the local currency of Country X (LCX). A has a foreign controlled entity (Entity B) in Country Y whose functional currency is the local currency of Country Y (LCY). B is the owner of a debt instrument, which is held for trading and therefore carried at fair value under IPSAS 29.

In B's financial statements for year 20X0, the fair value and carrying amount of the debt instrument is LCY100 in the local currency of Country Y. In A's consolidated financial statements, the asset is translated into the local currency of Country X at the spot exchange rate applicable at the end of the reporting period (2.00). Thus, the carrying amount is LCX200 (= LCY100 × 2.00) in the consolidated financial statements.

At the end of year 20X1, the fair value of the debt instrument has increased to LCY110 in the local currency of Country Y. B recognizes the trading asset at LCY110 in its statement of financial position and recognizes a fair value gain of LCY10 in its surplus or deficit. During the year, the spot exchange rate has increased

from 2.00 to 3.00 resulting in an increase in the fair value of the instrument from LCX200 to LCX330 ($= \text{LCY110} \times 3.00$) in the currency of Country X. Therefore, Entity A recognizes the trading asset at LCX330 in its consolidated financial statements.

Entity A translates the statement of changes in net assets/equity of B “at the exchange rates at the dates of the transactions” (IPSAS 4.44(b)). Since the fair value gain has accrued through the year, A uses the average rate as a practical approximation ($[(3.00 + 2.00) / 2 = 2.50]$, in accordance with IPSAS 4.25). Therefore, while the fair value of the trading asset has increased by LCX130 ($= \text{LCX330} - \text{LCX200}$), Entity A recognizes only LCX25 ($= \text{LCY10} \times 2.5$) of this increase in consolidated surplus or deficit to comply with IPSAS 4.44(b). The resulting exchange difference, i.e., the remaining increase in the fair value of the debt instrument ($\text{LCX130} - \text{LCX25} = \text{LCX105}$), is accumulated in net assets/equity until the disposal of the net investment in the foreign operation in accordance with IPSAS 4.57.

E.3.4 IPSAS 29 and IPSAS 4: Interaction between IPSAS 29 and IPSAS 4

IPSAS 29 includes requirements about the measurement of financial assets and financial liabilities and the recognition of gains and losses on remeasurement in surplus or deficit. IPSAS 4 includes rules about the reporting of foreign currency items and the recognition of exchange differences in surplus or deficit. In what order are IPSAS 4 and IPSAS 29 applied?

Statement of Financial Position

Generally, the measurement of a financial asset or financial liability at fair value, cost or amortized cost is first determined in the foreign currency in which the item is denominated in accordance with IPSAS 29. Then, the foreign currency amount is translated into the functional currency using the closing rate or a historical rate in accordance with IPSAS 4 (IPSAS 29.AG116). For example, if a monetary financial asset (such as a debt instrument) is carried at amortized cost under IPSAS 29, amortized cost is calculated in the currency of denomination of that financial asset. Then, the foreign currency amount is recognized using the closing rate in the entity’s financial statements (IPSAS 4.27). That applies regardless of whether a monetary item is measured at cost, amortized cost or fair value in the foreign currency (IPSAS 4.28). A non-monetary financial asset (such as an investment in an equity instrument) is translated using the closing rate if it is carried at fair value in the foreign currency (IPSAS 4.27(c)) and at a historical rate if it is not carried at fair value under IPSAS 29 because its fair value cannot be reliably measured (IPSAS 4.27(b) and IPSAS 29.48).

As an exception, if the financial asset or financial liability is designated as a hedged item in a fair value hedge of the exposure to changes in foreign currency rates under IPSAS 29, the hedged item is remeasured for changes in foreign currency rates even

if it would otherwise have been recognized using a historical rate under IPSAS 4 (IPSAS 29.99), i.e., the foreign currency amount is recognized using the closing rate. This exception applies to non-monetary items that are carried in terms of historical cost in the foreign currency and are hedged against exposure to foreign currency rates (IPSAS 4.27(b)).

Surplus or Deficit

The recognition of a change in the carrying amount of a financial asset or financial liability in surplus or deficit depends on a number of factors, including whether it is an exchange difference or other change in carrying amount, whether it arises on a monetary item (e.g., most debt instruments) or non-monetary item (such as most equity investments), whether the associated asset or liability is designated as a cash flow hedge of an exposure to changes in foreign currency rates, and whether it results from translating the financial statements of a foreign operation. The issue of recognizing changes in the carrying amount of a financial asset or financial liability held by a foreign operation is addressed in a separate question (see Question E.3.3).

Any exchange difference arising on recognizing a monetary item at a rate different from that at which it was initially recognized during the period, or recognized in previous financial statements, is recognized in surplus or deficit or in net assets/equity in accordance with IPSAS 4 (IPSAS 29.AG116, IPSAS 4.32 and IPSAS 4.37), unless the monetary item is designated as a cash flow hedge of a highly probable forecast transaction in foreign currency, in which case the requirements for recognition of gains and losses on cash flow hedges in IPSAS 29 apply (IPSAS 29.106). Differences arising from recognizing a monetary item at a foreign currency amount different from that at which it was previously recognized are accounted for in a similar manner, since all changes in the carrying amount relating to foreign currency movements should be treated consistently. All other changes in the statement of financial position measurement of a monetary item are recognized in surplus or deficit or in net assets/equity in accordance with IPSAS 29. For example, although an entity recognizes gains and losses on available-for-sale monetary financial assets in net assets/equity (IPSAS 29.64(b)), the entity nevertheless recognizes the changes in the carrying amount relating to changes in foreign exchange rates in surplus or deficit (IPSAS 4.27(a)).

Any changes in the carrying amount of a non-monetary item are recognized in surplus or deficit or in net assets/equity in accordance with IPSAS 29 (IPSAS 29.AG116). For example, for available-for-sale financial assets the entire change in the carrying amount, including the effect of changes in foreign currency rates, is recognized in net assets/equity. If the non-monetary item is designated as a cash flow hedge of an unrecognized firm commitment or a highly probable forecast transaction in foreign currency, the requirements for recognition of gains and losses on cash flow hedges in IPSAS 29 apply (IPSAS 29.106).

When some portion of the change in carrying amount is recognized in net assets/equity and some portion is recognized in surplus or deficit, for example, if the

amortized cost of a foreign currency bond classified as available for sale has increased in foreign currency (resulting in a gain in surplus or deficit) but its fair value has decreased in the functional currency (resulting in a loss recognized in net assets/equity), an entity cannot offset those two components for the purposes of determining gains or losses that should be recognized in surplus or deficit or in net assets/equity.

E.4 *Impairment and Uncollectibility of Financial Assets*

E.4.1 **Objective Evidence of Impairment**

Does IPSAS 29 require that an entity be able to identify a single, distinct past causative event to conclude that it is probable that an impairment loss on a financial asset has been incurred?

No. IPSAS 29.68 states “It may not be possible to identify a single, discrete event that caused the impairment. Rather the combined effect of several events may have caused the impairment.” Also, IPSAS 29.69 states that “a downgrade of an entity’s credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information.” Other factors that an entity considers in determining whether it has objective evidence that an impairment loss has been incurred include information about the debtors’ or issuers’ liquidity, solvency and business and financial risk exposures, levels of and trends in delinquencies for similar financial assets, national and local economic trends and conditions, and the fair value of collateral and guarantees. These and other factors may, either individually or taken together, provide sufficient objective evidence that an impairment loss has been incurred in a financial asset or group of financial assets.

E.4.2 **Impairment: Future Losses**

Does IPSAS 29 permit the recognition of an impairment loss through the establishment of an allowance for future losses when a loan is given? For example, if Entity A lends CU1,000 to Customer B, can it recognize an immediate impairment loss of CU10 if Entity A, based on historical experience, expects that 1 percent of the principal amount of loans given will not be collected?

No. IPSAS 29.45 requires a financial asset to be initially measured at fair value. For a loan asset, the fair value is the amount of cash lent adjusted for any fees and costs (unless a portion of the amount lent is compensation for other stated or implied rights or privileges). In addition, IPSAS 29.67 requires that an impairment loss is recognized only if there is objective evidence of impairment as a result of a past event that occurred after initial recognition. Accordingly, it is inconsistent with IPSAS 29.45 and IPSAS 29.67 to reduce the carrying amount of a loan asset on initial recognition through the recognition of an immediate impairment loss.

E.4.3 Assessment of Impairment: Principal and Interest

Because of Customer B's financial difficulties, Entity A is concerned that Customer B will not be able to make all principal and interest payments due on a loan in a timely manner. It negotiates a restructuring of the loan. Entity A expects that Customer B will be able to meet its obligations under the restructured terms. Would Entity A recognize an impairment loss if the restructured terms are as reflected in any of the following cases?

- (a) **Customer B will pay the full principal amount of the original loan five years after the original due date, but none of the interest due under the original terms.**
- (b) **Customer B will pay the full principal amount of the original loan on the original due date, but none of the interest due under the original terms.**
- (c) **Customer B will pay the full principal amount of the original loan on the original due date with interest only at a lower interest rate than the interest rate inherent in the original loan.**
- (d) **Customer B will pay the full principal amount of the original loan five years after the original due date and all interest accrued during the original loan term, but no interest for the extended term.**
- (e) **Customer B will pay the full principal amount of the original loan five years after the original due date and all interest, including interest for both the original term of the loan and the extended term.**

IPSAS 29.67 indicates that an impairment loss has been incurred if there is objective evidence of impairment. The amount of the impairment loss for a loan measured at amortized cost is the difference between the carrying amount of the loan and the present value of future principal and interest payments discounted at the loan's original effective interest rate. In cases (a)–(d) above, the present value of the future principal and interest payments discounted at the loan's original effective interest rate will be lower than the carrying amount of the loan. Therefore, an impairment loss is recognized in those cases.

In case (e), even though the timing of payments has changed, the lender will receive interest on interest, and the present value of the future principal and interest payments discounted at the loan's original effective interest rate will equal the carrying amount of the loan. Therefore, there is no impairment loss. However, this fact pattern is unlikely given Customer B's financial difficulties.

E.4.4 Assessment of Impairment: Fair Value Hedge

A loan with fixed interest rate payments is hedged against the exposure to interest rate risk by a receive-variable, pay-fixed interest rate swap. The hedge relationship qualifies for fair value hedge accounting and is reported as a fair value hedge. Thus, the carrying amount of the loan includes an adjustment for

fair value changes attributable to movements in interest rates. Should an assessment of impairment in the loan take into account the fair value adjustment for interest rate risk?

Yes. The loan's original effective interest rate before the hedge becomes irrelevant once the carrying amount of the loan is adjusted for any changes in its fair value attributable to interest rate movements. Therefore, the original effective interest rate and amortized cost of the loan are adjusted to take into account recognized fair value changes. The adjusted effective interest rate is calculated using the adjusted carrying amount of the loan.

An impairment loss on the hedged loan is calculated as the difference between its carrying amount after adjustment for fair value changes attributable to the risk being hedged and the estimated future cash flows of the loan discounted at the adjusted effective interest rate. When a loan is included in a portfolio hedge of interest rate risk, the entity should allocate the change in the fair value of the hedged portfolio to the loans (or groups of similar loans) being assessed for impairment on a systematic and rational basis.

E.4.5 Impairment: Provision Matrix

An entity calculates impairment in the unsecured portion of loans and receivables on the basis of a provision matrix that specifies fixed provision rates for the number of days a loan has been classified as non-performing (zero percent if less than 90 days, 20 percent if 90–180 days, 50 percent if 181–365 days and 100 percent if more than 365 days). Can the results be considered to be appropriate for the purpose of calculating the impairment loss on loans and receivables under IPSAS 29.72?

Not necessarily. IPSAS 29.72 requires impairment or bad debt losses to be calculated as the difference between the asset's carrying amount and the present value of estimated future cash flows discounted at the financial instrument's original effective interest rate.

E.4.6 Impairment: Excess Losses

Does IPSAS 29 permit an entity to recognize impairment or bad debt losses in excess of impairment losses that are determined on the basis of objective evidence about impairment in identified individual financial assets or identified groups of similar financial assets?

No. IPSAS 29 does not permit an entity to recognize impairment or bad debt losses in addition to those that can be attributed to individually identified financial assets or identified groups of financial assets with similar credit risk characteristics (IPSAS 29.73) on the basis of objective evidence about the existence of impairment in those assets (IPSAS 29.67). Amounts that an entity might want to set aside for additional possible impairment in financial assets, such as reserves that cannot be supported by objective evidence about impairment, are not recognized as impairment or bad debt

losses under IPSAS 29. However, if an entity determines that no objective evidence of impairment exists for an individually assessed financial asset, whether significant or not, it includes the asset in a group of financial assets with similar credit risk characteristics (IPSAS 29.73).

E.4.7 Recognition of Impairment on a Portfolio

IPSAS 29.72 requires that impairment be recognized for financial assets carried at amortized cost. IPSAS 29.73 states that impairment may be measured and recognized individually or on a portfolio basis for a group of similar financial assets. If one asset in the group is impaired but the fair value of another asset in the group is above its amortized cost, does IPSAS 29 allow non-recognition of the impairment of the first asset?

No. If an entity knows that an individual financial asset carried at amortized cost is impaired, IPSAS 29.72 requires that the impairment of that asset should be recognized. It states: “the amount of the loss is measured as the difference between *the asset’s* carrying amount and the present value of estimated future cash flows (excluding future credit losses that have not been incurred) discounted at the financial asset’s original effective interest rate” (emphasis added). Measurement of impairment on a portfolio basis under IPSAS 29.73 may be applied to groups of small balance items and to financial assets that are individually assessed and found not to be impaired when there is indication of impairment in a group of similar assets and impairment cannot be identified with an individual asset in that group.

E.4.8 Impairment: Recognition of Collateral

If an impaired financial asset is secured by collateral that does not meet the recognition criteria for assets in other Standards, is the collateral recognized as an asset separate from the impaired financial asset?

No. The measurement of the impaired financial asset reflects the fair value of the collateral. The collateral is not recognized as an asset separate from the impaired financial asset unless it meets the recognition criteria for an asset in another Standard.

E.4.9 Impairment of Non-Monetary Available-For-Sale Financial Asset

If a non-monetary financial asset, such as an equity instrument, measured at fair value with gains and losses recognized in net assets/equity becomes impaired, should the cumulative net loss recognized in net assets/equity, including any portion attributable to foreign currency changes, be reclassified from net assets/equity to surplus or deficit as a reclassification adjustment?

Yes. IPSAS 29.76 states that when a decline in the fair value of an available-for-sale financial asset has been recognized in net assets/equity and there is objective evidence that the asset is impaired, the cumulative net loss that had been recognized

in net assets/equity should be recognized in surplus or deficit even though the asset has not been derecognized. Any portion of the cumulative net loss that is attributable to foreign currency changes on that asset that had been recognized in net assets/equity is also recognized in surplus or deficit. Any subsequent losses, including any portion attributable to foreign currency changes, are also recognized in surplus or deficit until the asset is derecognized.

E.4.10 Impairment: Whether the Available-For-Sale Reserve in Net Assets/Equity can be Negative

IPSAS 29 requires that gains and losses arising from changes in fair value on available-for-sale financial assets are recognized in net assets/equity. If the aggregate fair value of such assets is less than their carrying amount, should the aggregate net loss that has been recognized in net assets/equity be recognized in surplus or deficit?

Not necessarily. The relevant criterion is not whether the aggregate fair value is less than the carrying amount, but whether there is objective evidence that a financial asset or group of assets is impaired. An entity assesses at the end of each reporting period whether there is any objective evidence that a financial asset or group of assets may be impaired, in accordance with IPSAS 29.68–70. IPSAS 29.69 states that a downgrade of an entity's credit rating is not, of itself, evidence of impairment, although it may be evidence of impairment when considered with other available information. Additionally, a decline in the fair value of a financial asset below its cost or amortized cost is not necessarily evidence of impairment (e.g., a decline in the fair value of an investment in a debt instrument that results from an increase in the basic, risk-free interest rate).

Section F: Hedging

F.1 Hedging Instruments

F.1.1 Hedging the Fair Value Exposure of a Bond Denominated in a Foreign Currency

Entity J, whose functional currency is the Japanese yen, has issued 5 million five-year US dollar fixed rate debt. Also, it owns a 5 million five-year fixed rate US dollar bond which it has classified as available for sale. Can Entity J designate its US dollar liability as a hedging instrument in a fair value hedge of the entire fair value exposure of its US dollar bond?

No. IPSAS 29.81 permits a non-derivative to be used as a hedging instrument only for a hedge of a foreign currency risk. Entity J's bond has a fair value exposure to foreign currency and interest rate changes and credit risk.

Alternatively, can the US dollar liability be designated as a fair value hedge or cash flow hedge of the foreign currency component of the bond?

Yes. However, hedge accounting is unnecessary because the amortized cost of the hedging instrument and the hedged item are both remeasured using closing rates. Regardless of whether Entity J designates the relationship as a cash flow hedge or a fair value hedge, the effect on surplus or deficit is the same. Any gain or loss on the non-derivative hedging instrument designated as a cash flow hedge is immediately recognized in surplus or deficit to correspond with the recognition of the change in spot rate on the hedged item in surplus or deficit as required by IPSAS 4.

F.1.2 Hedging with a Non-Derivative Financial Asset or Liability

Entity J's functional currency is the Japanese yen. It has issued a fixed rate debt instrument with semi-annual interest payments that matures in two years with principal due at maturity of 5 million US dollars. It has also entered into a fixed price sales commitment for 5 million US dollars that matures in two years and is not accounted for as a derivative because it meets the exemption for normal sales in paragraph 4. Can Entity J designate its US dollar liability as a fair value hedge of the entire fair value exposure of its fixed price sales commitment and qualify for hedge accounting?

No. IPSAS 29.81 permits a non-derivative asset or liability to be used as a hedging instrument only for a hedge of a foreign currency risk.

Alternatively, can Entity J designate its US dollar liability as a cash flow hedge of the foreign currency exposure associated with the future receipt of US dollars on the fixed price sales commitment?

Yes. IPSAS 29 permits the designation of a non-derivative asset or liability as a hedging instrument in either a cash flow hedge or a fair value hedge of the exposure to changes in foreign exchange rates of a firm commitment (IPSAS 29.97). Any gain or loss on the non-derivative hedging instrument that is recognized in net assets/equity during the period preceding the future sale is recognized in surplus or deficit when the sale takes place (IPSAS 29.106).

Alternatively, can Entity J designate the sales commitment as the hedging instrument instead of the hedged item?

No. Only a derivative instrument or a non-derivative financial asset or liability can be designated as a hedging instrument in a hedge of a foreign currency risk. A firm commitment cannot be designated as a hedging instrument. However, if the foreign currency component of the sales commitment is required to be separated as an embedded derivative under IPSAS 29.12 and IPSAS 29.AG46, it could be designated as a hedging instrument in a hedge of the exposure to changes in the fair value of the maturity amount of the debt attributable to foreign currency risk.

F.1.3 **Hedge Accounting: Use of Written Options in Combined Hedging Instruments**

Issue (a) – Does IPSAS 29.AG127 preclude the use of an interest rate collar or other derivative instrument that combines a written option component and a purchased option component as a hedging instrument?

It depends. An interest rate collar or other derivative instrument that includes a written option cannot be designated as a hedging instrument if it is a net written option, because IPSAS 29.AG127 precludes the use of a written option as a hedging instrument unless it is designated as an offset to a purchased option. An interest rate collar or other derivative instrument that includes a written option may be designated as a hedging instrument, however, if the combination is a net purchased option or zero cost collar.

Issue (b) – What factors indicate that an interest rate collar or other derivative instrument that combines a written option component and a purchased option component is not a net written option?

The following factors taken together suggest that an interest rate collar or other derivative instrument that includes a written option is not a net written option.

- (a) No net premium is received either at inception or over the life of the combination of options. The distinguishing feature of a written option is the receipt of a premium to compensate the writer for the risk incurred.
- (b) Except for the strike prices, the critical terms and conditions of the written option component and the purchased option component are the same (including underlying variable or variables, currency denomination and maturity date). Also, the notional amount of the written option component is not greater than the notional amount of the purchased option component.

F.1.4 **Internal Hedges**

Some entities use internal derivative contracts (internal hedges) to transfer risk exposures between different entities within an economic entity or divisions within a single legal entity. Does IPSAS 29.82 prohibit hedge accounting in such cases?

Yes, if the derivative contracts are internal to the entity being reported on. IPSAS 29 does not specify how an entity should manage its risk. However, it states that internal hedging transactions do not qualify for hedge accounting. This applies both (a) in consolidated financial statements for hedging transactions within an economic entity, and (b) in the individual or separate financial statements of a legal entity for hedging transactions between divisions in the entity. The principles of preparing consolidated financial statements in IPSAS 6.49 requires that “Balances, transactions, revenue and expenses within the economic entity shall be eliminated in full.”

On the other hand, hedging transaction within an economic entity may be designated as a hedge in the individual or separate financial statements of an individual entity, if the transaction is an external transaction from the perspective of the economic entity. In addition, if the internal contract is offset with an external party the external contract may be regarded as the hedging instrument and the hedging relationship may qualify for hedge accounting.

The following summarizes the application of IPSAS 29 to internal hedging transactions.

- IPSAS 29 does not preclude an entity from using internal derivative contracts for risk management purposes and it does not preclude internal derivatives from being accumulated at the treasury level or some other central location so that risk can be managed on an entity-wide basis or at some higher level than the separate legal entity or division.
- Internal derivative contracts between two separate entities within an economic entity can qualify for hedge accounting by those entities in their individual or separate financial statements, even though the internal contracts are not offset by derivative contracts with a party external to the economic entity.
- Internal derivative contracts between two separate divisions within the same legal entity can qualify for hedge accounting in the individual or separate financial statements of that legal entity only if those contracts are offset by derivative contracts with a party external to the legal entity.
- Internal derivative contracts between separate divisions within the same legal entity and between separate entities within the economic entity can qualify for hedge accounting in the consolidated financial statements only if the internal contracts are offset by derivative contracts with a party external to the economic entity.
- If the internal derivative contracts are not offset by derivative contracts with external parties, the use of hedge accounting by individual entities and divisions using internal contracts must be reversed on consolidation.

To illustrate: the treasury division of Entity A enters into an internal interest rate swap with another division of the same entity. The purpose is to hedge the interest rate risk exposure of a loan (or group of similar loans) in the loan portfolio. Under the swap, the treasury division pays fixed interest payments to the trading division and receives variable interest rate payments in return.

If a hedging instrument is not acquired from an external party, IPSAS 29 does not allow hedge accounting treatment for the hedging transaction undertaken by the treasury and other divisions. IPSAS 29.82 indicates that only derivatives that involve a party external to the entity can be designated as hedging instruments and, further, that any gains or losses on transactions within an economic entity or within individual entities should be eliminated on consolidation. Therefore, transactions between different divisions within Entity A do not qualify for hedge accounting

treatment in the financial statements of Entity A. Similarly, transactions between different entities within an economic entity do not qualify for hedge accounting treatment in consolidated financial statements.

However, if in addition to the internal swap in the above example the trading division enters into an interest rate swap or other contract with an external party that offsets the exposure hedged in the internal swap, hedge accounting is permitted under IPSAS 29. For the purposes of IPSAS 29, the hedged item is the loan (or group of similar loans) in the treasury division and the hedging instrument is the external interest rate swap or other contract.

The trading division may aggregate several internal swaps or portions of them that are not offsetting each other and enter into a single third party derivative contract that offsets the aggregate exposure. Under IPSAS 29, such external hedging transactions may qualify for hedge accounting treatment provided that the hedged items in the treasury division are identified and the other conditions for hedge accounting are met. It should be noted, however, that IPSAS 29.88 does not permit hedge accounting treatment for held-to-maturity investments if the hedged risk is the exposure to interest rate changes.

F.1.5 Offsetting Internal Derivative Contracts Used to Manage Interest Rate Risk

If a central treasury function enters into internal derivative contracts with controlled entities and various divisions within the economic entity to manage interest rate risk on a centralized basis, can those contracts qualify for hedge accounting in the consolidated financial statements if, before laying off the risk, the internal contracts are first netted against each other and only the net exposure is offset in the marketplace with external derivative contracts?

No. An internal contract designated at the controlled entity level or by a division as a hedge results in the recognition of changes in the fair value of the item being hedged in surplus or deficit (a fair value hedge) or in the recognition of the changes in the fair value of the internal derivative in net assets/equity (a cash flow hedge). There is no basis for changing the measurement attribute of the item being hedged in a fair value hedge unless the exposure is offset with an external derivative. There is also no basis for recognizing the gain or loss on the internal derivative in net assets/equity for one entity and recognizing it in surplus or deficit by the other entity unless it is offset with an external derivative. In cases where two or more internal derivatives are used to manage interest rate risk on assets or liabilities at the controlled entity or division level and those internal derivatives are offset at the treasury level, the effect of designating the internal derivatives as hedging instruments is that the hedged non-derivative exposures at the controlled entity or division levels would be used to offset each other on consolidation. Accordingly, since IPSAS 29.81 does not permit designating non-derivatives as hedging instruments, except for foreign currency exposures, the results of hedge accounting from the use of internal derivatives at the

controlled entity or division level that are not laid off with external parties must be reversed on consolidation.

It should be noted, however, that there will be no effect on surplus or deficit and net assets/equity of reversing the effect of hedge accounting in consolidation for internal derivatives that offset each other at the consolidation level if they are used in the same type of hedging relationship at the controlled entity or division level and, in the case of cash flow hedges, where the hedged items affect surplus or deficit in the same period. Just as the internal derivatives offset at the treasury level, their use as fair value hedges by two separate entities or divisions within the consolidated group will also result in the offset of the fair value amounts recognized in surplus or deficit, and their use as cash flow hedges by two separate entities or divisions within the economic entity will also result in the fair value amounts being offset against each other in net assets/equity. However, there may be an effect on individual line items in both the consolidated statement of changes in net assets/equity and the consolidated statement of financial position, for example when internal derivatives that hedge assets (or liabilities) in a fair value hedge are offset by internal derivatives that are used as a fair value hedge of other assets (or liabilities) that are recognized in a different line item in the statement of financial position or statement of changes in net assets/equity. In addition, to the extent that one of the internal contracts is used as a cash flow hedge and the other is used in a fair value hedge, gains and losses recognized would not offset since the gain (or loss) on the internal derivative used as a fair value hedge would be recognized in surplus or deficit and the corresponding loss (or gain) on the internal derivative used as a cash flow hedge would be recognized in net assets/equity.

Question F.1.4 describes the application of IPSAS 29 to internal hedging transactions.

F.1.6 Offsetting Internal Derivative Contracts Used to Manage Foreign Currency Risk

If a central treasury function enters into internal derivative contracts with controlled entities and various divisions within the economic entity to manage foreign currency risk on a centralized basis, can those contracts be used as a basis for identifying external transactions that qualify for hedge accounting in the consolidated financial statements if, before laying off the risk, the internal contracts are first netted against each other and only the net exposure is offset by entering into a derivative contract with an external party?

It depends. IPSAS 6, *Consolidated and Separate Financial Statements* requires all internal transactions to be eliminated in consolidated financial statements. As stated in IPSAS 29.82, internal hedging transactions do not qualify for hedge accounting in the consolidated financial statements of the economic entity. Therefore, if an entity wishes to achieve hedge accounting in the consolidated financial statements, it must designate a hedging relationship between a qualifying external hedging instrument and a qualifying hedged item.

As discussed in Question F.1.5, the accounting effect of two or more internal derivatives that are used to manage interest rate risk at the controlled entity or division level and are offset at the treasury level is that the hedged non-derivative exposures at those levels would be used to offset each other on consolidation. There is no effect on surplus or deficit or net assets/equity if (a) the internal derivatives are used in the same type of hedge relationship (i.e., fair value or cash flow hedges) and (b), in the case of cash flow hedges, any derivative gains and losses that are initially recognized in net assets/equity are recognized in surplus or deficit in the same period(s). When these two conditions are met, the gains and losses on the internal derivatives that are recognized in surplus or deficit or in net assets/equity will offset on consolidation resulting in the same surplus or deficit and net assets/equity as if the derivatives had been eliminated. However, there may be an effect on individual line items, in both the consolidated statement of changes in net assets/equity, and the consolidated statement of financial position, that would need to be eliminated. In addition, there is an effect on surplus or deficit and net assets/equity if some of the offsetting internal derivatives are used in cash flow hedges, while others are used in fair value hedges. There is also an effect on surplus or deficit and net assets/equity for offsetting internal derivatives that are used in cash flow hedges if the derivative gains and losses that are initially recognized in net assets/equity are recognized in surplus or deficit in different periods (because the hedged items affect surplus or deficit in different periods).

As regards foreign currency risk, provided that the internal derivatives represent the transfer of foreign currency risk on underlying non-derivative financial assets or liabilities, hedge accounting can be applied because IPSAS 29.81 permits a non-derivative financial asset or liability to be designated as a hedging instrument for hedge accounting purposes for a hedge of a foreign currency risk. Accordingly, in this case the internal derivative contracts can be used as a basis for identifying external transactions that qualify for hedge accounting in the consolidated financial statements even if they are offset against each other. However, for consolidated financial statements, it is necessary to designate the hedging relationship so that it involves only external transactions.

Furthermore, the entity cannot apply hedge accounting to the extent that two or more offsetting internal derivatives represent the transfer of foreign currency risk on underlying forecast transactions or unrecognized firm commitments. This is because an unrecognized firm commitment or forecast transaction does not qualify as a hedging instrument under IPSAS 29. Accordingly, in this case the internal derivatives cannot be used as a basis for identifying external transactions that qualify for hedge accounting in the consolidated financial statements. As a result, any cumulative net gain or loss on an internal derivative that has been included in the initial carrying amount of an asset or liability (basis adjustment) or recognized in net assets/equity would have to be reversed on consolidation if it cannot be demonstrated that the offsetting internal derivative represented the transfer of a foreign currency risk on a financial asset or liability to an external hedging instrument.

F.1.7 Internal Derivatives: Examples of Applying Question F.1.6

In each case, FC = foreign currency, LC = local currency (which is the entity's functional currency), and TC = treasury center.

Case 1: Offset of Fair Value Hedges

Controlled Entity A has trade receivables of FC100, due in 60 days, which it hedges using a forward contract with TC. Controlled Entity B has payables of FC50, also due in 60 days, which it hedges using a forward contract with TC.

TC nets the two internal derivatives and enters into a net external forward contract to pay FC50 and receive LC in 60 days.

At the end of month 1, FC weakens against LC. A incurs a foreign exchange loss of LC10 on its receivables, offset by a gain of LC10 on its forward contract with TC. B makes a foreign exchange gain of LC5 on its payables offset by a loss of LC5 on its forward contract with TC. TC makes a loss of LC10 on its internal forward contract with A, a gain of LC5 on its internal forward contract with B, and a gain of LC5 on its external forward contract.

At the end of month 1, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting transactions or events within the economic entity are shown in italics.

A's entries

Dr	Foreign exchange loss	LC10	
	Cr Receivables		LC10
<i>Dr</i>	<i>Internal contract TC</i>	<i>LC10</i>	
	<i>Cr Internal gain TC</i>		<i>LC10</i>

B's entries

Dr	Payables	LC5	
	Cr Foreign exchange gain		LC5
<i>Dr</i>	<i>Internal loss TC</i>	<i>LC5</i>	
	<i>Cr Internal contract TC</i>		<i>LC5</i>

TC's entries

<i>Dr</i>	<i>Internal loss A</i>	<i>LC10</i>	
	<i>Cr Internal contract A</i>		<i>LC10</i>
<i>Dr</i>	<i>Internal contract B</i>	<i>LC5</i>	
	<i>Cr Internal gain B</i>		<i>LC5</i>
Dr	External forward contract	LC5	
	Cr Foreign exchange gain		LC5

Both A and B could apply hedge accounting in their individual financial statements provided all conditions in IPSAS 29 are met. However, in this case, no hedge

accounting is required because gains and losses on the internal derivatives and the offsetting losses and gains on the hedged receivables and payables are recognized immediately in surplus or deficit of A and B without hedge accounting.

In the consolidated financial statements, the internal derivative transactions are eliminated. In economic terms, the payable in B hedges FC50 of the receivables in A. The external forward contract in TC hedges the remaining FC50 of the receivable in A. Hedge accounting is not necessary in the consolidated financial statements because monetary items are measured at spot foreign exchange rates under IPSAS 4 irrespective of whether hedge accounting is applied.

The net balances before and after elimination of the accounting entries relating to the internal derivatives are the same, as set out below. Accordingly, there is no need to make any further accounting entries to meet the requirements of IPSAS 29.

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
External forward contract	LC5	–
Gains and losses	–	–
Internal contracts	–	–

Case 2: Offset of Cash Flow Hedges

To extend the example, A also has highly probable future revenues of FC200 on which it expects to receive cash in 90 days. B has highly probable future expenses of FC500 (rental for offices), also to be paid for in 90 days. A and B enter into separate forward contracts with TC to hedge these exposures and TC enters into an external forward contract to receive FC300 in 90 days.

As before, FC weakens at the end of month 1. A incurs a “loss” of LC20 on its anticipated revenues because the LC value of these revenues decreases. This is offset by a “gain” of LC20 on its forward contract with TC.

B incurs a “gain” of LC50 on its anticipated advertising cost because the LC value of the expense decreases. This is offset by a “loss” of LC50 on its transaction with TC.

TC incurs a “gain” of LC50 on its internal transaction with B, a “loss” of LC20 on its internal transaction with A and a loss of LC30 on its external forward contract.

A and B complete the necessary documentation, the hedges are effective, and both A and B qualify for hedge accounting in their individual financial statements. A recognizes the gain of LC20 on its internal derivative transaction in net assets/equity and B recognizes the loss of LC50 in net assets/equity. TC does not claim hedge accounting, but measures both its internal and external derivative positions at fair value, which net to zero.

At the end of month 1, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting transactions or events within the economic entity are shown in italics.

A's entries

<i>Dr</i>	<i>Internal contract TC</i>	<i>LC20</i>	
	<i>Cr</i>	<i>Net assets/equity</i>	<i>LC20</i>

B's entries

<i>Dr</i>	<i>Net assets/equity</i>	<i>LC50</i>	
	<i>Cr</i>	<i>Internal contract TC</i>	<i>LC50</i>

TC's entries

<i>Dr</i>	<i>Internal loss A</i>	<i>LC20</i>	
	<i>Cr</i>	<i>Internal contract</i>	<i>Cr A</i>
			<i>LC20</i>
<i>Dr</i>	<i>Internal contract B</i>	<i>LC50</i>	
	<i>Cr</i>	<i>Internal gain B</i>	<i>LC50</i>
<i>Dr</i>	Foreign exchange loss	LC30	
	<i>Cr</i>	<i>External forward contract</i>	<i>LC30</i>

For the consolidated financial statements, TC's external forward contract on FC300 is designated, at the beginning of month 1, as a hedging instrument of the first FC300 of B's highly probable future expenses. IPSAS 29 requires that in the consolidated financial statements at the end of month 1, the accounting effects of the internal derivative transactions must be eliminated.

However, the net balances before and after elimination of the accounting entries relating to the internal derivatives are the same, as set out below. Accordingly, there is no need to make any further accounting entries in order for the requirements of IPSAS 29 to be met.

	<i>Debit</i>	<i>Credit</i>
External forward contract	—	LC30
Net assets/equity	LC30	—
Gains and losses	—	—
Internal contracts	—	—

Case 3: Offset of Fair Value and Cash Flow Hedges

Assume that the exposures and the internal derivative transactions are the same as in cases 1 and 2. However, instead of entering into two external derivatives to hedge separately the fair value and cash flow exposures, TC enters into a single net external derivative to receive FC250 in exchange for LC in 90 days.

TC has four internal derivatives, two maturing in 60 days and two maturing in 90 days. These are offset by a net external derivative maturing in 90 days. The interest

rate differential between FC and LC is minimal, and therefore the ineffectiveness resulting from the mismatch in maturities is expected to have a minimal effect on surplus or deficit in TC.

As in cases 1 and 2, A and B apply hedge accounting for their cash flow hedges and TC measures its derivatives at fair value. A recognizes a gain of LC20 on its internal derivative transaction in net assets/equity and B recognizes a loss of LC50 on its internal derivative transaction in net assets/equity.

At the end of month 1, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting transactions or events within the economic entity are shown in *italics*.

A's entries

Dr	Foreign exchange loss	LC10	
	Cr Receivables		LC10
<i>Dr</i>	<i>Internal contract TC</i>	<i>LC10</i>	
	<i>Cr Internal gain TC</i>		<i>LC10</i>
<i>Dr</i>	<i>Internal contract TC</i>	<i>LC20</i>	
	<i>Cr Net assets/equity</i>		<i>LC20</i>

B's entries

Dr	Payables	LC5	
	Cr Foreign exchange gain		LC5
<i>Dr</i>	<i>Internal loss TC</i>	<i>LC5</i>	
	<i>Cr Internal contract TC</i>		<i>LC5</i>
<i>Dr</i>	<i>Net assets/equity</i>	<i>LC50</i>	
	<i>Cr Internal contract TC</i>		<i>LC50</i>

TC's entries

<i>Dr</i>	<i>Internal loss A</i>	<i>LC10</i>	
	<i>Cr Internal contract A</i>		<i>LC10</i>
<i>Dr</i>	<i>Internal loss A</i>	<i>LC20</i>	
	<i>Cr Internal contract A</i>		<i>LC20</i>
<i>Dr</i>	<i>Internal contract B</i>	<i>LC5</i>	
	<i>Cr Internal gain B</i>		<i>LC5</i>
<i>Dr</i>	<i>Internal contract B</i>	<i>LC50</i>	
	<i>Cr Internal gain B</i>		<i>LC50</i>
Dr	Foreign exchange loss	LC25	
	Cr External forward contract		LC25

TOTAL (for the internal derivatives)	A	B	Total
	<i>LC</i>	<i>LC</i>	<i>TC</i>
Surplus or deficit (fair value hedges)	10	(5)	5
Net assets/equity (cash flow hedges)	20	(50)	(30)
Total	30	(55)	(25)

Combining these amounts with the external transactions (i.e., those not marked in italics above) produces the total net balances before elimination of the internal derivatives as follows:

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
Forward contract	–	LC25
Net assets/equity	LC30	–
Gains and losses	–	–
Internal contracts	–	–

For the consolidated financial statements, the following designations are made at the beginning of month 1:

- The payable of FC50 in B is designated as a hedge of the first FC50 of the highly probable future revenues in A. Therefore, at the end of month 1, the following entries are made in the consolidated financial statements: Dr Payable LC5; Cr Net assets/equity LC5;
- The receivable of FC100 in A is designated as a hedge of the first FC100 of the highly probable future expenses in B. Therefore, at the end of month 1, the following entries are made in the consolidated financial statements: Dr Net assets/equity LC10; Cr Receivable LC10; and
- The external forward contract on FC250 in TC is designated as a hedge of the next FC250 of highly probable future expenses in B. Therefore, at the end of month 1, the following entries are made in the consolidated financial statements: Dr Net assets/equity LC25; Cr External forward contract LC25.

In the consolidated financial statements at the end of month 1, IPSAS 29 requires the accounting effects of the internal derivative transactions to be eliminated.

However, the total net balances before and after elimination of the accounting entries relating to the internal derivatives are the same, as set out below. Accordingly, there is no need to make any further accounting entries to meet the requirements of IPSAS 29.

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
Forward contract	–	LC25
Net assets/equity	LC30	–
Gains and losses	–	–
Internal contracts	–	–

Case 4: Offset of Fair Value and Cash Flow Hedges with Adjustment to Carrying Amount of Inventory

Assume similar transactions as in case 3, except that the anticipated cash outflow of FC500 in B relates to the purchase of inventory that is delivered after 60 days. Assume also that the entity has a policy of basis-adjusting hedged forecast non-financial items. At the end of month 2, there are no further changes in exchange rates or fair values. At that date, the inventory is delivered and the loss of LC50 on B's internal derivative, recognized in net assets/equity in month 1, is adjusted against the carrying amount of inventory in B. The gain of LC20 on A's internal derivative is recognized in net assets/equity as before.

In the consolidated financial statements, there is now a mismatch compared with the result that would have been achieved by unwinding and redesignating the hedges. The external derivative (FC250) and a proportion of the receivable (FC50) offset FC300 of the anticipated inventory purchase. There is a natural hedge between the remaining FC200 of anticipated cash outflow in B and the anticipated cash inflow of FC200 in A. This relationship does not qualify for hedge accounting under IPSAS 29 and this time there is only a partial offset between gains and losses on the internal derivatives that hedge these amounts.

At the end of months 1 and 2, the following entries are made in the individual or separate financial statements of A, B and TC. Entries reflecting transactions or events within the economic entity are shown in italics.

A's entries (all at the end of month 1)

Dr	Foreign exchange loss	LC10	
	Cr	Receivables	LC10
Dr	<i>Internal contract TC</i>	<i>LC10</i>	
	Cr	<i>Internal gain TC</i>	<i>LC10</i>
Dr	<i>Internal contract TC</i>	<i>LC20</i>	
	Cr	<i>Net assets/equity</i>	<i>LC20</i>

B's entries

At the end of month 1:

Dr	Payables	LC5	
	Cr Foreign exchange gain		LC5
<i>Dr</i>	<i>Internal loss TC</i>	<i>LC5</i>	
	<i>Cr Internal contract TC</i>		<i>LC5</i>
<i>Dr</i>	<i>Net assets/equity</i>	<i>LC50</i>	
	<i>Cr Internal contract TC</i>		<i>LC50</i>

At the end of month 2:

Dr	Inventory	LC50	
	Cr Net assets/equity		LC50

TC's entries (all at the end of month 1)

<i>Dr</i>	<i>Internal loss A</i>	<i>LC10</i>	
	<i>Cr Internal contract A</i>		<i>LC10</i>
<i>Dr</i>	<i>Internal loss A</i>	<i>LC20</i>	
	<i>Cr Internal contract A</i>		<i>LC20</i>
<i>Dr</i>	<i>Internal contract B</i>	<i>LC5</i>	
	<i>Cr Internal gain B</i>		<i>LC5</i>
<i>Dr</i>	<i>Internal contract B</i>	<i>LC50</i>	
	<i>Cr Internal gain B</i>		<i>LC50</i>
Dr	Foreign exchange loss	LC25	
	Cr Forward		LC25

TOTAL (for the internal derivatives)	<i>A</i>	<i>B</i>	<i>Total</i>
	<i>LC</i>	<i>LC</i>	<i>TC</i>
Surplus or deficit (fair value hedges)	10	(5)	5
Net assets/equity (cash flow hedges)	20	–	20
Basis adjustment (inventory)	–	(50)	(50)
Total	30	(55)	(25)

Combining these amounts with the external transactions (i.e., those not marked in italics above) produces the total net balances before elimination of the internal derivatives as follows:

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
Forward contract	–	LC25
Net assets/equity	–	LC20
Basis adjustment (inventory)	LC50	–
Gains and losses	–	–
Internal contracts	–	–

For the consolidated financial statements, the following designations are made at the beginning of month 1:

- The payable of FC50 in B is designated as a hedge of the first FC50 of the highly probable future revenues in A. Therefore, at the end of month 1, the following entry is made in the consolidated financial statements: Dr Payables LC5; Cr Net assets/equity LC5.
- The receivable of FC100 in A is designated as a hedge of the first FC100 of the highly probable future expenses in B. Therefore, at the end of month 1, the following entries are made in the consolidated financial statements: Dr Net assets/equity LC10; Cr Receivable LC10; and at the end of month 2, Dr Inventory LC10; Cr Net assets/equity LC10.
- The external forward contract on FC250 in TC is designated as a hedge of the next FC250 of highly probable future expenses in B. Therefore, at the end of month 1, the following entry is made in the consolidated financial statements: Dr Net assets/equity LC25; Cr External forward contract LC25; and at the end of month 2, Dr Inventory LC25; Cr Net assets/equity LC25.

The total net balances after elimination of the accounting entries relating to the internal derivatives are as follows:

	<i>Debit</i>	<i>Credit</i>
Receivables	–	LC10
Payables	LC5	–
Forward contract	–	LC25
Net assets/equity	–	LC5
Basis adjustment (inventory)	LC35	–
Gains and losses	–	–
Internal contracts	–	–

These total net balances are different from those that would be recognized if the internal derivatives were not eliminated, and it is these net balances that IPSAS 29

requires to be included in the consolidated financial statements. The accounting entries required to adjust the total net balances before elimination of the internal derivatives are as follows:

- (a) To reclassify LC15 of the loss on B's internal derivative that is included in inventory to reflect that FC150 of the forecast purchase of inventory is not hedged by an external instrument (neither the external forward contract of FC250 in TC nor the external payable of FC100 in A); and
- (b) To reclassify the gain of LC15 on A's internal derivative to reflect that the forecast revenues of FC150 to which it relates is not hedged by an external instrument.

The net effect of these two adjustments is as follows:

Dr	Net assets/equity	LC15	
	Cr	Inventory	LC15

F.1.8 Combination of Written and Purchased Options

In most cases, IPSAS 29.AG127 prohibits the use of written options as hedging instruments. If a combination of a written option and purchased option (such as an interest rate collar) is transacted as a single instrument with one counterparty, can an entity split the derivative instrument into its written option component and purchased option component and designate the purchased option component as a hedging instrument?

No. IPSAS 29.83 specifies that a hedging relationship is designated by an entity for a hedging instrument in its entirety. The only exceptions permitted are splitting the time value and intrinsic value of an option and splitting the interest element and spot price on a forward. Question F.1.3 addresses the issue of whether and when a combination of options is considered as a written option.

F.1.9 Delta-Neutral Hedging Strategy

Does IPSAS 29 permit an entity to apply hedge accounting for a “delta-neutral” hedging strategy and other dynamic hedging strategies under which the quantity of the hedging instrument is constantly adjusted in order to maintain a desired hedge ratio, for example, to achieve a delta-neutral position insensitive to changes in the fair value of the hedged item?

Yes. IPSAS 29.83 states that “a dynamic hedging strategy that assesses both the intrinsic value and time value of an option contract can qualify for hedge accounting.” For example, a portfolio insurance strategy that seeks to ensure that the fair value of the hedged item does not drop below a certain level, while allowing the fair value to increase, may qualify for hedge accounting.

To qualify for hedge accounting, the entity must document how it will monitor and update the hedge and measure hedge effectiveness, be able to track properly all terminations and redesignations of the hedging instrument, and demonstrate that all

other criteria for hedge accounting in IPSAS 29.98 are met. Also, it must be able to demonstrate an expectation that the hedge will be highly effective for a specified short period of time during which the hedge is not expected to be adjusted.

F.1.10 Hedging Instrument: Out of the Money Put Option

Entity A has an investment in one share of Entity B, which it has classified as available for sale. To give itself partial protection against decreases in the share price of Entity B, Entity A acquires a put option on one share of Entity B and designates the change in the intrinsic value of the put as a hedging instrument in a fair value hedge of changes in the fair value of its share in Entity B. The put gives Entity A the right to sell one share of Entity B at a strike price of CU90. At the inception of the hedging relationship, the share has a quoted price of CU100. Since the put option gives Entity A the right to dispose of the share at a price of CU90, the put should normally be fully effective in offsetting price declines below CU90 on an intrinsic value basis. Price changes above CU90 are not hedged. In this case, are changes in the fair value of the share of Entity B for prices above CU90 regarded as hedge ineffectiveness under IPSAS 29.98 and recognized in surplus or deficit under IPSAS 29.99?

No. IPSAS 29.83 permits Entity A to designate changes in the intrinsic value of the option as the hedging instrument. The changes in the intrinsic value of the option provide protection against the risk of variability in the fair value of one share of Entity B below or equal to the strike price of the put of CU90. For prices above CU90, the option is out of the money and has no intrinsic value. Accordingly, gains and losses on one share of Entity B for prices above CU90 are not attributable to the hedged risk for the purposes of assessing hedge effectiveness and recognizing gains and losses on the hedged item.

Therefore, Entity A recognizes changes in the fair value of the share in net assets/equity if it is associated with variation in its price above CU90 (IPSAS 29.64 and IPSAS 29.101). Changes in the fair value of the share associated with price declines below CU90 form part of the designated fair value hedge and are recognized in surplus or deficit under IPSAS 29.99(b). Assuming the hedge is effective, those changes are offset by changes in the intrinsic value of the put, which are also recognized in surplus or deficit (IPSAS 29.99(a)). Changes in the time value of the put are excluded from the designated hedging relationship and recognized in surplus or deficit under IPSAS 29.65(a).

F.1.11 Hedging Instrument: Proportion of the Cash Flows of a Cash Instrument

In the case of foreign exchange risk, a non-derivative financial asset or non-derivative financial liability can potentially qualify as a hedging instrument. Can an entity treat the cash flows for specified periods during which a financial asset or financial liability that is designated as a hedging instrument remains

outstanding as a proportion of the hedging instrument under IPSAS 29.84, and exclude the other cash flows from the designated hedging relationship?

No. IPSAS 29.84 indicates that a hedging relationship may not be designated for only a portion of the time period in which the hedging instrument is outstanding. For example, the cash flows during the first three years of a ten-year borrowing denominated in a foreign currency cannot qualify as a hedging instrument in a cash flow hedge of the first three years of revenue in the same foreign currency. On the other hand, a non-derivative financial asset or financial liability denominated in a foreign currency may potentially qualify as a hedging instrument in a hedge of the foreign currency risk associated with a hedged item that has a remaining time period until maturity that is equal to or longer than the remaining maturity of the hedging instrument (see Question F.2.17).

F.1.12 Hedges of More Than One Type of Risk

Issue (a) – Normally a hedging relationship is designated between an entire hedging instrument and a hedged item so that there is a single measure of fair value for the hedging instrument. Does this preclude designating a single financial instrument simultaneously as a hedging instrument in both a cash flow hedge and a fair value hedge?

No. For example, entities commonly use a combined interest rate and currency swap to convert a variable rate position in a foreign currency to a fixed rate position in the functional currency. IPSAS 29.85 allows the swap to be designated separately as a fair value hedge of the currency risk and a cash flow hedge of the interest rate risk provided the conditions in IPSAS 29.85 are met.

Issue (b) – If a single financial instrument is a hedging instrument in two different hedges, is special disclosure required?

IPSAS 30.25 requires disclosures separately for designated fair value hedges, cash flow hedges and hedges of a net investment in a foreign operation. The instrument in question would be reported in the IPSAS 30.25 disclosures separately for each type of hedge.

F.1.13 Hedging Instrument: Dual Foreign Currency Forward Exchange Contract

Entity A's functional currency is the Japanese yen. Entity A has a five-year floating rate US dollar liability and a ten-year fixed rate pound sterling-denominated note receivable. The principal amounts of the asset and liability when converted into the Japanese yen are the same. Entity A enters into a single foreign currency forward contract to hedge its foreign currency exposure on both instruments under which it receives US dollars and pays pounds sterling at the end of five years. If Entity A designates the forward exchange contract as a hedging instrument in a cash flow hedge against the foreign currency exposure

on the principal repayments of both instruments, can it qualify for hedge accounting?

Yes. IPSAS 29.85 permits designating a single hedging instrument as a hedge of multiple types of risk if three conditions are met. In this example, the derivative hedging instrument satisfies all of these conditions, as follows.

- (a) The risks hedged can be identified clearly. The risks are the exposures to changes in the exchange rates between US dollars and yen, and yen and pounds, respectively.
- (b) The effectiveness of the hedge can be demonstrated. For the pound sterling loan, the effectiveness is measured as the degree of offset between the fair value of the principal repayment in pounds sterling and the fair value of the pound sterling payment on the forward exchange contract. For the US dollar liability, the effectiveness is measured as the degree of offset between the fair value of the principal repayment in US dollars and the US dollar receipt on the forward exchange contract. Even though the receivable has a ten-year life and the forward protects it for only the first five years, hedge accounting is permitted for only a portion of the exposure as described in Question F.2.17.
- (c) It is possible to ensure that there is specific designation of the hedging instrument and different risk positions. The hedged exposures are identified as the principal amounts of the liability and the note receivable in their respective currency of denomination.

F.1.14 Concurrent Offsetting Swaps and Use of One as a Hedging Instrument

Entity A enters into an interest rate swap and designates it as a hedge of the fair value exposure associated with fixed rate debt. The fair value hedge meets the hedge accounting criteria of IPSAS 29. Entity A simultaneously enters into a second interest rate swap with the same swap counterparty that has terms that fully offset the first interest rate swap. Is Entity A required to view the two swaps as one unit and therefore precluded from applying fair value hedge accounting to the first swap?

It depends. IPSAS 29 is transaction-based. If the second swap was not entered into in contemplation of the first swap or there is a substantive business purpose for structuring the transactions separately, then the swaps are not viewed as one unit.

For example, some entities have a policy that requires a centralized treasury (which is a controlled entity in an economic entity) enter into third-party derivative contracts on behalf of other controlled entities within the organization to hedge the controlled entities' interest rate risk exposures. The treasury also enters into internal derivative transactions with those controlled entities in order to track those hedges operationally within the organization. Because the treasury also enters into derivative contracts as part of its trading operations, or because it may wish to rebalance the risk of its

overall portfolio, it may enter into a derivative contract with the same third party during the same business day that has substantially the same terms as a contract entered into as a hedging instrument on behalf of another controlled entity. In this case, there is a valid business purpose for entering into each contract.

Judgment is applied to determine whether there is a substantive business purpose for structuring the transactions separately. For example, if the sole purpose is to obtain fair value accounting treatment for the debt, there is no substantive business purpose.

F.2 *Hedged Items*

F.2.1 **Whether a Derivative can be Designated as a Hedged Item**

Does IPSAS 29 permit designating a derivative instrument (whether a stand-alone or separately recognized embedded derivative) as a hedged item either individually or as part of a hedged group in a fair value or cash flow hedge, for example, by designating a pay-variable, receive-fixed Forward Rate Agreement (FRA) as a cash flow hedge of a pay-fixed, receive-variable FRA?

No. Derivative instruments are always deemed held for trading and measured at fair value with gains and losses recognized in surplus or deficit unless they are designated and effective hedging instruments (IPSAS 29.10). As an exception, IPSAS 29.AG127 permits the designation of a purchased option as the hedged item in a fair value hedge.

F.2.2 **Cash Flow Hedge: Anticipated Issue of Fixed Rate Debt**

Is hedge accounting allowed for a hedge of an anticipated issue of fixed rate debt?

Yes. This would be a cash flow hedge of a highly probable forecast transaction that will affect surplus or deficit (IPSAS 29.96) provided that the conditions in IPSAS 29.98 are met.

To illustrate: Entity R periodically issues new bonds to refinance maturing bonds, provide working capital and for various other purposes. When Entity R decides it will be issuing bonds, it may hedge the risk of changes in the long-term interest rate from the date it decides to issue the bonds to the date the bonds are issued. If long-term interest rates go up, the bond will be issued either at a higher rate or with a higher discount or smaller premium than was originally expected. The higher rate being paid or decrease in proceeds is normally offset by the gain on the hedge. If long-term interest rates go down, the bond will be issued either at a lower rate or with a higher premium or a smaller discount than was originally expected. The lower rate being paid or increase in proceeds is normally offset by the loss on the hedge.

For example, in August 2000 Entity R decided it would issue CU200 million seven-year bonds in January 2001. Entity R performed historical correlation studies and determined that a seven-year treasury bond adequately correlates to the bonds Entity R expected to issue, assuming a hedge ratio of 0.93 futures contracts to one debt unit.

Therefore, Entity R hedged the anticipated issue of the bonds by selling (shorting) CU186 million worth of futures on seven-year treasury bonds. From August 2000 to January 2001 interest rates increased. The short futures positions were closed in January 2001, the date the bonds were issued, and resulted in a CU1.2 million gain that will offset the increased interest payments on the bonds and, therefore, will affect surplus or deficit over the life of the bonds. The hedge qualifies as a cash flow hedge of the interest rate risk on the forecast issue of debt.

F.2.3 Hedge Accounting: Core Deposit Intangibles

Is hedge accounting treatment permitted for a hedge of the fair value exposure of core deposit intangibles?

It depends on whether the core deposit intangible is generated internally or acquired (e.g., as part of an entity combination).

Internally generated core deposit intangibles are not recognized as intangible assets under IPSAS 31, *Intangible Assets*. Because they are not recognized, they cannot be designated as a hedged item.

If a core deposit intangible is acquired together with a related portfolio of deposits, the core deposit intangible is required to be recognized separately as an intangible asset (or as part of the related acquired portfolio of deposits) if it meets the recognition criteria in IPSAS 31. A recognized core deposit intangible asset could be designated as a hedged item, but only if it meets the conditions in paragraph 98, including the requirement in paragraph 98 that the effectiveness of the hedge can be measured reliably. Because it is often difficult to measure reliably the fair value of a core deposit intangible asset other than on initial recognition, it is unlikely that the requirement in paragraph 98(d) will be met.

F.2.4 Hedge Accounting: Hedging of Future Foreign Currency Revenue Streams

Is hedge accounting permitted for a currency borrowing that hedges an expected but not contractual revenue stream in foreign currency?

Yes, if the revenues are highly probable. Under IPSAS 29.96(b) a hedge of an anticipated sale may qualify as a cash flow hedge. For example, an entity which owns and operates a cross-border toll road may use sophisticated models based on experience and economic data to project its revenues in various currencies. If it can demonstrate that forecast revenues for a period of time into the future in a particular currency are “highly probable,” as required by IPSAS 29.98, it may designate a currency borrowing as a cash flow hedge of the future revenue stream. The portion of the gain or loss on the borrowing that is determined to be an effective hedge is recognized in net assets/equity until the revenues occur.

It is unlikely that an entity can reliably predict 100 percent of revenues for a future year. On the other hand, it is possible that a portion of predicted revenues, normally those expected in the short term, will meet the “highly probable” criterion.

F.2.5 Cash Flow Hedges: “All in One” Hedge

If a derivative instrument is expected to be settled gross by delivery of the underlying asset in exchange for the payment of a fixed price, can the derivative instrument be designated as the hedging instrument in a cash flow hedge of that gross settlement assuming the other cash flow hedge accounting criteria are met?

Yes. A derivative instrument that will be settled gross can be designated as the hedging instrument in a cash flow hedge of the variability of the consideration to be paid or received in the future transaction that will occur on gross settlement of the derivative contract itself because there would be an exposure to variability in the purchase or sale price without the derivative. This applies to all fixed price contracts that are accounted for as derivatives under IPSAS 29.

For example, if an entity enters into a fixed price contract to sell a commodity and that contract is accounted for as a derivative under IPSAS 29 (e.g., because the entity has a practice of settling such contracts net in cash or of taking delivery of the underlying and selling it within a short period after delivery for the purpose of generating a profit from short-term fluctuations in price or dealer’s margin), the entity may designate the fixed price contract as a cash flow hedge of the variability of the consideration to be received on the sale of the asset (a future transaction) even though the fixed price contract is the contract under which the asset will be sold. Also, if an entity enters into a forward contract to purchase a debt instrument that will be settled by delivery, but the forward contract is a derivative because its term exceeds the regular way delivery period in the marketplace, the entity may designate the forward as a cash flow hedge of the variability of the consideration to be paid to acquire the debt instrument (a future transaction), even though the derivative is the contract under which the debt instrument will be acquired.

F.2.6 Hedge Relationships: Entity-Wide Risk

An entity has a fixed rate asset and a fixed rate liability, each having the same principal amount. Under the terms of the instruments, interest payments on the asset and liability occur in the same period and the net cash flow is always positive because the interest rate on the asset exceeds the interest rate on the liability. The entity enters into an interest rate swap to receive a floating interest rate and pay a fixed interest rate on a notional amount equal to the principal of the asset and designates the interest rate swap as a fair value hedge of the fixed rate asset. Does the hedging relationship qualify for hedge accounting even though the effect of the interest rate swap on an entity-wide basis is to create an exposure to interest rate changes that did not previously exist?

Yes. IPSAS 29 does not require risk reduction on an entity-wide basis as a condition for hedge accounting. Exposure is assessed on a transaction basis and, in this instance, the asset being hedged has a fair value exposure to interest rate increases that is offset by the interest rate swap.

F.2.7 Cash Flow Hedge: Forecast Transaction Related to an Entity's Net Assets/Equity

Can a forecast transaction in the entity's own equity instruments or forecast dividend or similar payments to owners be designated as a hedged item in a cash flow hedge?

No. To qualify as a hedged item, the forecast transaction must expose the entity to a particular risk that can affect surplus or deficit (IPSAS 29.96). The classification of financial instruments as liabilities or net assets/equity generally provides the basis for determining whether transactions or other payments relating to such instruments are recognized in surplus or deficit IPSAS 28. For example, distributions to holders of an equity instrument are debited by the issuer directly to net assets/equity (IPSAS 28.40). Therefore, such distributions cannot be designated as a hedged item. However, a declared dividend or similar distribution that has not yet been paid and is recognized as a financial liability may qualify as a hedged item, for example, for foreign currency risk if it is denominated in a foreign currency.

F.2.8 Hedge Accounting: Risk of a Transaction Not Occurring

Does IPSAS 29 permit an entity to apply hedge accounting to a hedge of the risk that a transaction will not occur, for example, if that would result in less revenue to the entity than expected?

No. The risk that a transaction will not occur is an overall operational risk that is not eligible as a hedged item. Hedge accounting is permitted only for risks associated with recognized assets and liabilities, firm commitments, highly probable forecast transactions and net investments in foreign operations (IPSAS 29.96).

F.2.9 Held-to-Maturity Investments: Hedging Variable Interest Rate Payments

Can an entity designate a pay-variable, receive-fixed interest rate swap as a cash flow hedge of a variable rate, held-to-maturity investment?

No. It is inconsistent with the designation of a debt investment as being held to maturity to designate a swap as a cash flow hedge of the debt investment's variable interest rate payments. IPSAS 29.88 states that a held-to-maturity investment cannot be a hedged item with respect to interest rate risk or prepayment risk "because designation of an investment as held to maturity requires an intention to hold the investment until maturity without regard to changes in the fair value or cash flows of such an investment attributable to changes in interest rates."

F.2.10 Hedged Items: Purchase of Held-to-Maturity Investment

An entity forecasts the purchase of a financial asset that it intends to classify as held to maturity when the forecast transaction occurs. It enters into a derivative contract with the intent to lock in the current interest rate and designates the derivative as a hedge of the forecast purchase of the financial asset. Can the

hedging relationship qualify for cash flow hedge accounting even though the asset will be classified as a held-to-maturity investment?

Yes. With respect to interest rate risk, IPSAS 29 prohibits hedge accounting for financial assets that are classified as held-to-maturity (IPSAS 29.88). However, even though the entity intends to classify the asset as held to maturity, the instrument is not classified as such until the transaction occurs.

F.2.11 Cash Flow Hedges: Reinvestment of Funds Obtained from Held-to-Maturity Investments

An entity owns a variable rate asset that it has classified as held to maturity. It enters into a derivative contract with the intention to lock in the current interest rate on the reinvestment of variable rate cash flows, and designates the derivative as a cash flow hedge of the forecast future interest receipts on debt instruments resulting from the reinvestment of interest receipts on the held-to-maturity asset. Assuming that the other hedge accounting criteria are met, can the hedging relationship qualify for cash flow hedge accounting even though the interest payments that are being reinvested come from an asset that is classified as held to maturity?

Yes. IPSAS 29.88 states that a held-to-maturity investment cannot be a hedged item with respect to interest rate risk. Question F.2.8 specifies that this applies not only to fair value hedges, i.e., hedges of the exposure to fair value interest rate risk associated with held-to-maturity investments that pay fixed interest, but also to cash flow hedges, i.e., hedges of the exposure to cash flow interest rate risk associated with held-to-maturity investments that pay variable interest at current market rates. However, in this instance, the derivative is designated as an offset of the exposure to cash flow risk associated with forecast future interest receipts on debt instruments resulting from the forecast reinvestment of variable rate cash flows on the held-to-maturity investment. The source of the funds forecast to be reinvested is not relevant in determining whether the reinvestment risk can be hedged. Accordingly, designation of the derivative as a cash flow hedge is permitted. This answer applies also to a hedge of the exposure to cash flow risk associated with the forecast future interest receipts on debt instruments resulting from the reinvestment of interest receipts on a fixed rate asset classified as held to maturity.

F.2.12 Hedge Accounting: Prepayable Financial Asset

If the issuer has the right to prepay a financial asset, can the investor designate the cash flows after the prepayment date as part of the hedged item?

Cash flows after the prepayment date may be designated as the hedged item to the extent it can be demonstrated that they are “highly probable” (IPSAS 29.98). For example, cash flows after the prepayment date may qualify as highly probable if they result from a group or pool of similar assets (e.g., mortgage loans) for which prepayments can be estimated with a high degree of accuracy or if the prepayment option is significantly out of the money. In addition, the cash flows after the

prepayment date may be designated as the hedged item if a comparable option exists in the hedging instrument.

F.2.13 Fair Value Hedge: Risk That Could Affect Surplus or Deficit

Is fair value hedge accounting permitted for exposure to interest rate risk in fixed rate loans that are classified as loans and receivables?

Yes. Under IPSAS 29, loans and receivables are carried at amortized cost. Many entities hold the bulk of their loans and receivables until maturity. Thus, changes in the fair value of such loans and receivables that are due to changes in market interest rates will not affect surplus or deficit. IPSAS 29.96 specifies that a fair value hedge is a hedge of the exposure to changes in fair value that is attributable to a particular risk and that can affect surplus or deficit. Therefore, IPSAS 29.96 may appear to preclude fair value hedge accounting for loans and receivables. However, it follows from IPSAS 29.88 that loans and receivables can be hedged items with respect to interest rate risk since they are not designated as held-to-maturity investments. The entity could sell them and the change in fair values would affect surplus or deficit. Thus, fair value hedge accounting is permitted for loans and receivables.

F.2.14 Intragroup and Intra-entity Hedging Transactions

An Australian entity, whose functional currency is the Australian dollar, has forecast purchases in Japanese yen that are highly probable. The Australian entity is wholly owned by a Swiss entity, which prepares consolidated financial statements (which include the Australian subsidiary) in Swiss francs. The Swiss controlling entity enters into a forward contract to hedge the change in yen relative to the Australian dollar. Can that hedge qualify for hedge accounting in the consolidated financial statements, or must the Australian controlled that has the foreign currency exposure be a party to the hedging transaction?

The hedge can qualify for hedge accounting provided the other hedge accounting criteria in IPSAS 29 are met. Since the Australian entity did not hedge the foreign currency exchange risk associated with the forecast purchases in yen, the effects of exchange rate changes between the Australian dollar and the yen will affect the Australian entity's surplus or deficit and, therefore, would also affect consolidated surplus or deficit. IPSAS 29 does not require that the operating unit that is exposed to the risk being hedged be a party to the hedging instrument.

F.2.15 Internal Contracts: Single Offsetting External Derivative

An entity uses what it describes as internal derivative contracts to document the transfer of responsibility for interest rate risk exposures from individual divisions to a central treasury function. The central treasury function aggregates the internal derivative contracts and enters into a single external derivative contract that offsets the internal derivative contracts on a net basis. For example, if the central treasury function has entered into three internal receive-fixed, pay-variable interest rate swaps that lay off the exposure to

variable interest cash flows on variable rate liabilities in other divisions and one internal receive-variable, pay-fixed interest rate swap that lays off the exposure to variable interest cash flows on variable rate assets in another division, it would enter into an interest rate swap with an external counterparty that exactly offsets the four internal swaps. Assuming that the hedge accounting criteria are met, in the entity's financial statements would the single offsetting external derivative qualify as a hedging instrument in a hedge of a part of the underlying items on a gross basis?

Yes, but only to the extent the external derivative is designated as an offset of cash inflows or cash outflows on a gross basis. IPSAS 29.94 indicates that a hedge of an overall net position does not qualify for hedge accounting. However, it does permit designating a part of the underlying items as the hedged position on a gross basis. Therefore, even though the purpose of entering into the external derivative was to offset internal derivative contracts on a net basis, hedge accounting is permitted if the hedging relationship is defined and documented as a hedge of a part of the underlying cash inflows or cash outflows on a gross basis. An entity follows the approach outlined in IPSAS 29.94 and IPSAS 29.AG141 to designate part of the underlying cash flows as the hedged position.

F.2.16 Internal Contracts: External Derivative Contracts that are Settled Net

Issue (a) – An entity uses internal derivative contracts to transfer interest rate risk exposures from individual divisions to a central treasury function. For each internal derivative contract, the central treasury function enters into a derivative contract with a single external counterparty that offsets the internal derivative contract. For example, if the central treasury function has entered into a receive-5 percent-fixed, pay-LIBOR interest rate swap with another division that has entered into the internal contract with central treasury to hedge the exposure to variability in interest cash flows on a pay-LIBOR borrowing, central treasury would enter into a pay-5 percent-fixed, receive-LIBOR interest rate swap on the same principal terms with the external counterparty. Although each of the external derivative contracts is formally documented as a separate contract, only the net of the payments on all of the external derivative contracts is settled since there is a netting agreement with the external counterparty. Assuming that the other hedge accounting criteria are met, can the individual external derivative contracts, such as the pay-5 percent-fixed, receive-LIBOR interest rate swap above, be designated as hedging instruments of underlying gross exposures, such as the exposure to changes in variable interest payments on the pay-LIBOR borrowing above, even though the external derivatives are settled on a net basis?

Generally, yes. External derivative contracts that are legally separate contracts and serve a valid business purpose, such as laying off risk exposures on a gross basis, qualify as hedging instruments even if those external contracts are settled on a net

basis with the same external counterparty, provided the hedge accounting criteria in IPSAS 29 are met. See also Question F.1.13.

Issue (b) – Treasury observes that by entering into the external offsetting contracts and including them in the centralized portfolio, it is no longer able to evaluate the exposures on a net basis. Treasury wishes to manage the portfolio of offsetting external derivatives separately from other exposures of the entity. Therefore, it enters into an additional, single derivative to offset the risk of the portfolio. Can the individual external derivative contracts in the portfolio still be designated as hedging instruments of underlying gross exposures even though a single external derivative is used to offset fully the market exposure created by entering into the external contracts?

Generally, yes. The purpose of structuring the external derivative contracts in this manner is consistent with the entity's risk management objectives and strategies. As indicated above, external derivative contracts that are legally separate contracts and serve a valid purpose qualify as hedging instruments. Moreover, the answer to Question F.1.13 specifies that hedge accounting is not precluded simply because the entity has entered into a swap that mirrors exactly the terms of another swap with the same counterparty if there is a substantive purpose for structuring the transactions separately.

F.2.17 Partial Term Hedging

IPSAS 29.84 indicates that a hedging relationship may not be designated for only a portion of the time period during which a hedging instrument remains outstanding. Is it permitted to designate a derivative as hedging only a portion of the time period to maturity of a hedged item?

Yes. A financial instrument may be a hedged item for only a portion of its cash flows or fair value, if effectiveness can be measured and the other hedge accounting criteria are met.

To illustrate: Entity A acquires a 10 percent fixed rate government bond with a remaining term to maturity of ten years. Entity A classifies the bond as available-for-sale. To hedge itself against fair value exposure on the bond associated with the present value of the interest rate payments until year 5, Entity A acquires a five-year pay-fixed, receive-floating swap. The swap may be designated as hedging the fair value exposure of the interest rate payments on the government bond until year 5 and the change in value of the principal payment due at maturity to the extent affected by changes in the yield curve relating to the five years of the swap.

F.2.18 Hedging Instrument: Cross-Currency Interest Rate Swap

Entity A's functional currency is the Japanese yen. Entity A has a five-year floating rate US dollar liability and a 10-year fixed rate pound sterling-denominated note receivable. Entity A wishes to hedge the foreign currency exposure on its asset and liability and the fair value interest rate exposure on

the receivable and enters into a matching cross-currency interest rate swap to receive floating rate US dollars and pay fixed rate pounds sterling and to exchange the dollars for the pounds at the end of five years. Can Entity A designate the swap as a hedging instrument in a fair value hedge against both foreign currency risk and interest rate risk, although both the pound sterling and US dollar are foreign currencies to Entity A?

Yes. IPSAS 29.90 permits hedge accounting for components of risk, if effectiveness can be measured. Also, IPSAS 29.85 permits designating a single hedging instrument as a hedge of more than one type of risk if the risks can be identified clearly, effectiveness can be demonstrated, and specific designation of the hedging instrument and different risk positions can be ensured. Therefore, the swap may be designated as a hedging instrument in a fair value hedge of the pound sterling receivable against exposure to changes in its fair value associated with changes in UK interest rates for the initial partial term of five years and the exchange rate between pounds and US dollars. The swap is measured at fair value with changes in fair value recognized in surplus or deficit. The carrying amount of the receivable is adjusted for changes in its fair value caused by changes in UK interest rates for the first five-year portion of the yield curve. The receivable and payable are remeasured using spot exchange rates under IPSAS 4 and the changes to their carrying amounts recognized in surplus or deficit.

F.2.19 Hedged Items: Hedge of Foreign Currency Risk of Publicly Traded Shares

Entity A acquires shares in Entity B on a foreign stock exchange for their fair value of 1,000 in foreign currency (FC). It classifies the shares as available for sale. To protect itself from the exposure to changes in the foreign exchange rate associated with the shares, it enters into a forward contract to sell FC750. Entity A intends to roll over the forward exchange contract for as long as it retains the shares. Assuming that the other hedge accounting criteria are met, could the forward exchange contract qualify as a hedge of the foreign exchange risk associated with the shares?

Yes, but only if there is a clear and identifiable exposure to changes in foreign exchange rates. Therefore, hedge accounting is permitted if (a) the equity instrument is not traded on an exchange (or in another established marketplace) where trades are denominated in the same currency as the functional currency of Entity A and (b) dividends to Entity A are not denominated in that currency. Thus, if a share is traded in multiple currencies and one of those currencies is the functional currency of the reporting entity, hedge accounting for the foreign currency component of the share price is not permitted.

If so, could the forward exchange contract be designated as a hedging instrument in a hedge of the foreign exchange risk associated with the portion of the fair value of the shares up to FC750 in foreign currency?

Yes. IPSAS 29 permits designating a portion of the cash flow or fair value of a financial asset as the hedged item if effectiveness can be measured (IPSAS 29.90). Therefore, Entity A may designate the forward exchange contract as a hedge of the foreign exchange risk associated with only a portion of the fair value of the shares in foreign currency. It could either be designated as a fair value hedge of the foreign exchange exposure of FC750 associated with the shares or as a cash flow hedge of a forecast sale of the shares, provided the timing of the sale is identified. Any variability in the fair value of the shares in foreign currency would not affect the assessment of hedge effectiveness unless the fair value of the shares in foreign currency was to fall below FC750.

F.2.20 Hedge Accounting: Stock Index

An entity may acquire a portfolio of shares to replicate a stock index and a put option on the index to protect itself from fair value losses. Does IPSAS 29 permit designating the put on the stock index as a hedging instrument in a hedge of the portfolio of shares?

No. If similar financial instruments are aggregated and hedged as a group, IPSAS 29.93 states that the change in fair value attributable to the hedged risk for each individual item in the group is expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group. In the scenario above, the change in the fair value attributable to the hedged risk for each individual item in the group (individual share prices) is not expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group.

F.2.21 Hedge Accounting: Netting of Assets and Liabilities

May an entity group financial assets together with financial liabilities for the purpose of determining the net cash flow exposure to be hedged for hedge accounting purposes?

An entity's hedging strategy and risk management practices may assess cash flow risk on a net basis but IPSAS 29.94 does not permit designating a net cash flow exposure as a hedged item for hedge accounting purposes. IPSAS 29.AG141 provides an example of how an entity might assess its risk on a net basis (with similar assets and liabilities grouped together) and then qualify for hedge accounting by hedging on a gross basis.

F.3 Hedge Accounting

F.3.1 Cash Flow Hedge: Fixed Interest Rate Cash Flows

An entity issues a fixed rate debt instrument and enters into a receive-fixed, pay-variable interest rate swap to offset the exposure to interest rate risk associated with the debt instrument. Can the entity designate the swap as a cash

flow hedge of the future interest cash outflows associated with the debt instrument?

No. IPSAS 29.96(b) states that a cash flow hedge is “a hedge of the exposure to variability in cash flows.” In this case, the issued debt instrument does not give rise to any exposure to variability in cash flows since the interest payments are fixed. The entity may designate the swap as a fair value hedge of the debt instrument, but it cannot designate the swap as a cash flow hedge of the future cash outflows of the debt instrument.

F.3.2 Cash Flow Hedge: Reinvestment of Fixed Interest Rate Cash Flows

An entity manages interest rate risk on a net basis. On January 1, 2001, it forecasts aggregate cash inflows of CU100 on fixed rate assets and aggregate cash outflows of CU90 on fixed rate liabilities in the first quarter of 2002. For risk management purposes it uses a receive-variable, pay-fixed Forward Rate Agreement (FRA) to hedge the forecast net cash inflow of CU10. The entity designates as the hedged item the first CU10 of cash inflows on fixed rate assets in the first quarter of 2002. Can it designate the receive-variable, pay-fixed FRA as a cash flow hedge of the exposure to variability to cash flows in the first quarter of 2002 associated with the fixed rate assets?

No. The FRA does not qualify as a cash flow hedge of the cash flow relating to the fixed rate assets because they do not have a cash flow exposure. The entity could, however, designate the FRA as a hedge of the fair value exposure that exists before the cash flows are remitted.

In some cases, the entity could also hedge the interest rate exposure associated with the forecast reinvestment of the interest and principal it receives on fixed rate assets (see Question F.6.2). However, in this example, the FRA does not qualify for cash flow hedge accounting because it increases rather than reduces the variability of interest cash flows resulting from the reinvestment of interest cash flows (e.g., if market rates increase, there will be a cash inflow on the FRA and an increase in the expected interest cash inflows resulting from the reinvestment of interest cash inflows on fixed rate assets). However, potentially it could qualify as a cash flow hedge of a portion of the refinancing of cash outflows on a gross basis.

F.3.3 Foreign Currency Hedge

Entity A has a foreign currency liability payable in six months' time and it wishes to hedge the amount payable on settlement against foreign currency fluctuations. To that end, it takes out a forward contract to buy the foreign currency in six months' time. Should the hedge be treated as:

- (a) A fair value hedge of the foreign currency liability with gains and losses on revaluing the liability and the forward contract at the year-end both recognized in surplus or deficit; or**

(b) A cash flow hedge of the amount to be settled in the future with gains and losses on revaluing the forward contract recognized net assets/equity?

IPSAS 29 does not preclude either of these two methods. If the hedge is treated as a fair value hedge, the gain or loss on the fair value remeasurement of the hedging instrument and the gain or loss on the fair value remeasurement of the hedged item for the hedged risk are recognized immediately in surplus or deficit. If the hedge is treated as a cash flow hedge with the gain or loss on remeasuring the forward contract recognized in net assets/equity, that amount is recognized in surplus or deficit in the same period or periods during which the hedged item (the liability) affects surplus or deficit, i.e., when the liability is remeasured for changes in foreign exchange rates. Therefore, if the hedge is effective, the gain or loss on the derivative is released to surplus or deficit in the same periods during which the liability is remeasured, not when the payment occurs. See Question F.3.4.

F.3.4 Foreign Currency Cash Flow Hedge

An entity exports a product at a price denominated in a foreign currency. At the date of the sale, the entity obtains a receivable for the sale price payable in 90 days and takes out a 90-day forward exchange contract in the same currency as the receivable to hedge its foreign currency exposure.

Under, the sale is recorded at the spot rate at the date of sale, and the receivable is restated during the 90-day period for changes in exchange rates with the difference being taken to surplus or deficit (IPSAS 4.27 and IPSAS 4.32).

If the foreign exchange contract is designated as a hedging instrument, does the entity have a choice whether to designate the foreign exchange contract as a fair value hedge of the foreign currency exposure of the receivable or as a cash flow hedge of the collection of the receivable?

Yes. If the entity designates the foreign exchange contract as a fair value hedge, the gain or loss from remeasuring the forward exchange contract at fair value is recognized immediately in surplus or deficit and the gain or loss on remeasuring the receivable is also recognized in surplus or deficit.

If the entity designates the foreign exchange contract as a cash flow hedge of the foreign currency risk associated with the collection of the receivable, the portion of the gain or loss that is determined to be an effective hedge is recognized in net assets/equity, and the ineffective portion in surplus or deficit (IPSAS 29.106). The amount recognized in net assets/equity is recognized in surplus or deficit in the same period or periods during which changes in the measurement of the receivable affect surplus or deficit (IPSAS 29.111).

F.3.5 Fair Value Hedge: Variable Rate Debt Instrument

Does IPSAS 29 permit an entity to designate a portion of the risk exposure of a variable rate debt instrument as a hedged item in a fair value hedge?

Yes. A variable rate debt instrument may have an exposure to changes in its fair value due to credit risk. It may also have an exposure to changes in its fair value relating to movements in the market interest rate in the periods between which the variable interest rate on the debt instrument is reset. For example, if the debt instrument provides for annual interest payments reset to the market rate each year, a portion of the debt instrument has an exposure to changes in fair value during the year.

F.3.6 Fair Value Hedge: Inventory

IPSAS 29.96(a) states that a fair value hedge is “a hedge of the exposure to changes in fair value of a recognized asset or liability ... that is attributable to a particular risk and could affect surplus or deficit.” Can an entity designate inventories, such as oil inventory, as the hedged item in a fair value hedge of the exposure to changes in the price of the inventories, such as the oil price, although inventories are measured at the lower of cost and net realizable value or cost and current replacement cost under IPSAS 12, *Inventories*?

Yes. The inventories may be hedged for changes in fair value due to changes in the copper price because the change in fair value of inventories will affect surplus or deficit when the inventories are sold or their carrying amount is written down. The adjusted carrying amount becomes the cost basis for the purpose of applying the lower of cost and net realizable value test under IPSAS 12. The hedging instrument used in a fair value hedge of inventories may alternatively qualify as a cash flow hedge of the future sale of the inventory.

F.3.7 Hedge Accounting: Forecast Transaction

For cash flow hedges, a forecast transaction that is subject to a hedge must be “highly probable.” How should the term “highly probable” be interpreted?

The term “highly probable” indicates a much greater likelihood of happening than the term “more likely than not.” An assessment of the likelihood that a forecast transaction will take place is not based solely on management’s intentions because intentions are not verifiable. A transaction’s probability should be supported by observable facts and the attendant circumstances.

In assessing the likelihood that a transaction will occur, an entity should consider the following circumstances:

- (a) The frequency of similar past transactions;
- (b) The financial and operational ability of the entity to carry out the transaction;

- (c) Substantial commitments of resources to a particular activity (e.g., the undertaking of specific infrastructure projects);
- (d) The extent of loss or disruption of operations that could result if the transaction does not occur;
- (e) The likelihood that transactions with substantially different characteristics might be used to achieve the same purpose (e.g., an entity that intends to raise cash may have several ways of doing so, ranging from a short-term bank loan to an offering of debt instruments); and
- (f) The entity's operational plan.

The length of time until a forecast transaction is projected to occur is also a factor in determining probability. Other factors being equal, the more distant a forecast transaction is, the less likely it is that the transaction would be regarded as highly probable and the stronger the evidence that would be needed to support an assertion that it is highly probable.

For example, a transaction forecast to occur in five years may be less likely to occur than a transaction forecast to occur in one year. However, forecast interest payments for the next 20 years on variable rate debt would typically be highly probable if supported by an existing contractual obligation.

In addition, other factors being equal, the greater the physical quantity or future value of a forecast transaction in proportion to the entity's transactions of the same nature, the less likely it is that the transaction would be regarded as highly probable and the stronger the evidence that would be required to support an assertion that it is highly probable. For example, less evidence generally would be needed to support forecast sales of 100,000 units in the next month than 950,000 units in that month when recent sales have averaged 950,000 units per month for the past three months.

A history of having designated hedges of forecast transactions and then determining that the forecast transactions are no longer expected to occur would call into question both an entity's ability to predict forecast transactions accurately and the propriety of using hedge accounting in the future for similar forecast transactions.

F.3.8 Retrospective Designation of Hedges

Does IPSAS 29 permit an entity to designate hedge relationships retrospectively?

No. Designation of hedge relationships takes effect prospectively from the date all hedge accounting criteria in IPSAS 29.98 are met. In particular, hedge accounting can be applied only from the date the entity has completed the necessary documentation of the hedge relationship, including identification of the hedging instrument, the related hedged item or transaction, the nature of the risk being hedged, and how the entity will assess hedge effectiveness.

F.3.9 Hedge Accounting: Designation at the Inception of the Hedge

Does IPSAS 29 permit an entity to designate and formally document a derivative contract as a hedging instrument after entering into the derivative contract?

Yes, prospectively. For hedge accounting purposes, IPSAS 29 requires a hedging instrument to be designated and formally documented as such from the inception of the hedge relationship (IPSAS 29.98); in other words, a hedge relationship cannot be designated retrospectively. Also, it precludes designating a hedging relationship for only a portion of the time period during which the hedging instrument remains outstanding (IPSAS 29.84). However, it does not require the hedging instrument to be acquired at the inception of the hedge relationship.

F.3.10 Hedge Accounting: Identification of Hedged Forecast Transaction

Can a forecast transaction be identified as the purchase or sale of the last 15,000 units of a product in a specified period or as a percentage of purchases or sales during a specified period?

No. The hedged forecast transaction must be identified and documented with sufficient specificity so that when the transaction occurs, it is clear whether the transaction is or is not the hedged transaction. Therefore, a forecast transaction may be identified as the sale of the first 15,000 units of a specific product during a specified three-month period, but it could not be identified as the last 15,000 units of that product sold during a three-month period because the last 15,000 units cannot be identified when they are sold. For the same reason, a forecast transaction cannot be specified solely as a percentage of sales or purchases during a period.

F.3.11 Cash Flow Hedge: Documentation of Timing of Forecast Transaction

For a hedge of a forecast transaction, should the documentation of the hedge relationship that is established at inception of the hedge identify the date on, or time period in which, the forecast transaction is expected to occur?

Yes. To qualify for hedge accounting, the hedge must relate to a specific identified and designated risk (IPSAS 29.AG151) and it must be possible to measure its effectiveness reliably (IPSAS 29.98(d)). Also, the hedged forecast transaction must be highly probable (IPSAS 29.98(c)). To meet these criteria, an entity is not required to predict and document the exact date a forecast transaction is expected to occur. However, it is required to identify and document the time period during which the forecast transaction is expected to occur within a reasonably specific and generally narrow range of time from a most probable date, as a basis for assessing hedge effectiveness. To determine that the hedge will be highly effective in accordance with IPSAS 29.98(d), it is necessary to ensure that changes in the fair value of the expected cash flows are offset by changes in the fair value of the hedging instrument and this test may be met only if the timing of the cash flows occur within close

proximity to each other. If the forecast transaction is no longer expected to occur, hedge accounting is discontinued in accordance with IPSAS 29.112(c).

F.4 *Hedge Effectiveness*

F.4.1 **Hedging on an After-Tax Basis**

Hedging is often done on an after-tax basis. Is hedge effectiveness assessed after taxes?

IPSAS 29 permits, but does not require, assessment of hedge effectiveness on an after-tax basis. If the hedge is undertaken on an after-tax basis, it is so designated at inception as part of the formal documentation of the hedging relationship and strategy.

F.4.2 **Hedge Effectiveness: Assessment on Cumulative Basis**

IPSAS 29.98(b) requires that the hedge is expected to be highly effective. Should expected hedge effectiveness be assessed separately for each period or cumulatively over the life of the hedging relationship?

Expected hedge effectiveness may be assessed on a cumulative basis if the hedge is so designated, and that condition is incorporated into the appropriate hedging documentation. Therefore, even if a hedge is not expected to be highly effective in a particular period, hedge accounting is not precluded if effectiveness is expected to remain sufficiently high over the life of the hedging relationship. However, any ineffectiveness is required to be recognized in surplus or deficit as it occurs.

To illustrate: an entity designates a LIBOR-based interest rate swap as a hedge of a borrowing whose interest rate is a UK base rate plus a margin. The UK base rate changes, perhaps, once each quarter or less, in increments of 25–50 basis points, while LIBOR changes daily. Over a period of 1–2 years, the hedge is expected to be almost perfect. However, there will be quarters when the UK base rate does not change at all, while LIBOR has changed significantly. This would not necessarily preclude hedge accounting.

F.4.3 **Hedge Effectiveness: Counterparty Credit Risk**

Must an entity consider the likelihood of default by the counterparty to the hedging instrument in assessing hedge effectiveness?

Yes. An entity cannot ignore whether it will be able to collect all amounts due under the contractual provisions of the hedging instrument. When assessing hedge effectiveness, both at the inception of the hedge and on an ongoing basis, the entity considers the risk that the counterparty to the hedging instrument will default by failing to make any contractual payments to the entity. For a cash flow hedge, if it becomes probable that a counterparty will default, an entity would be unable to conclude that the hedging relationship is expected to be highly effective in achieving offsetting cash flows. As a result, hedge accounting would be discontinued. For a fair

value hedge, if there is a change in the counterparty's creditworthiness, the fair value of the hedging instrument will change, which affects the assessment of whether the hedge relationship is effective and whether it qualifies for continued hedge accounting.

F.4.4 Hedge Effectiveness: Effectiveness Tests

How should hedge effectiveness be measured for the purposes of initially qualifying for hedge accounting and for continued qualification?

IPSAS 29 does not provide specific guidance about how effectiveness tests are performed. IPSAS 29 specifies that a hedge is normally regarded as highly effective only if (a) at inception and in subsequent periods, the hedge is expected to be highly effective in achieving offsetting changes in fair value or cash flows attributable to the hedged risk during the period for which the hedge is designated, and (b) the actual results are within a range of 80–125 percent. IPSAS 29.AG145 also states that the expectation in (a) can be demonstrated in various ways.

The appropriateness of a given method of assessing hedge effectiveness will depend on the nature of the risk being hedged and the type of hedging instrument used. The method of assessing effectiveness must be reasonable and consistent with other similar hedges unless different methods are explicitly justified. An entity is required to document at the inception of the hedge how effectiveness will be assessed and then to apply that effectiveness test on a consistent basis for the duration of the hedge.

Several mathematical techniques can be used to measure hedge effectiveness, including ratio analysis, i.e., a comparison of hedging gains and losses with the corresponding gains and losses on the hedged item at a point in time, and statistical measurement techniques such as regression analysis. If regression analysis is used, the entity's documented policies for assessing effectiveness must specify how the results of the regression will be assessed.

F.4.5 Hedge Effectiveness: Less than 100 Percent Offset

If a cash flow hedge is regarded as highly effective because the actual risk offset is within the allowed 80–125 percent range of deviation from full offset, is the gain or loss on the ineffective portion of the hedge recognized in net assets/equity?

No. IPSAS 29.106(a) indicates that only the effective portion is recognized in net assets/equity. IPSAS 29.106(b) requires the ineffective portion to be recognized in surplus or deficit.

F.4.6 Assuming Perfect Hedge Effectiveness

If the principal terms of the hedging instrument and of the entire hedged asset or liability or hedged forecast transaction are the same, can an entity assume perfect hedge effectiveness without further effectiveness testing?

No. IPSAS 29.98(e) requires an entity to assess hedges on an ongoing basis for hedge effectiveness. It cannot assume hedge effectiveness even if the principal terms of the hedging instrument and the hedged item are the same, since hedge ineffectiveness may arise because of other attributes such as the liquidity of the instruments or their credit risk (IPSAS 29.AG150). It may, however, designate only certain risks in an overall exposure as being hedged and thereby improve the effectiveness of the hedging relationship. For example, for a fair value hedge of a debt instrument, if the derivative hedging instrument has a credit risk that is equivalent to the AA-rate, it may designate only the risk related to AA-rated interest rate movements as being hedged, in which case changes in credit spreads generally will not affect the effectiveness of the hedge.

F.5 *Cash Flow Hedges*

F.5.1 **Hedge Accounting: Non-Derivative Monetary Asset or Non-Derivative Monetary Liability Used as a Hedging Instrument**

If an entity designates a non-derivative monetary asset as a foreign currency cash flow hedge of the repayment of the principal of a non-derivative monetary liability, would the exchange differences on the hedged item be recognized in surplus or deficit (IPSAS 4.32) and the exchange differences on the hedging instrument be recognized in net assets/equity until the repayment of the liability (IPSAS 29.106)?

No. Exchange differences on the monetary asset and the monetary liability are both recognized in surplus or deficit in the period in which they arise (IPSAS 4.32). IPSAS 29.AG116 specifies that if there is a hedge relationship between a non-derivative monetary asset and a non-derivative monetary liability, changes in fair values of those financial instruments are recognized in surplus or deficit.

F.5.2 **Cash Flow Hedges: Performance of Hedging Instrument (1)**

Entity A has a floating rate liability of CU1,000 with five years remaining to maturity. It enters into a five-year pay-fixed, receive-floating interest rate swap in the same currency and with the same principal terms as the liability to hedge the exposure to variable cash flow payments on the floating rate liability attributable to interest rate risk. At inception, the fair value of the swap is zero. Subsequently, there is an increase of CU49 in the fair value of the swap. This increase consists of a change of CU50 resulting from an increase in market interest rates and a change of minus CU1 resulting from an increase in the credit risk of the swap counterparty. There is no change in the fair value of the floating rate liability, but the fair value (present value) of the future cash flows needed to offset the exposure to variable interest cash flows on the liability increases by CU50. Assuming that Entity A determines that the hedge is still highly effective, is there ineffectiveness that should be recognized in surplus or deficit?

No. A hedge of interest rate risk is not fully effective if part of the change in the fair value of the derivative is attributable to the counterparty's credit risk (IPSAS 29.AG150). However, because Entity A determines that the hedge relationship is still highly effective, it recognizes the effective portion of the change in fair value of the swap, i.e., the net change in fair value of CU49, in net assets/equity. There is no debit to surplus or deficit for the change in fair value of the swap attributable to the deterioration in the credit quality of the swap counterparty, because the cumulative change in the present value of the future cash flows needed to offset the exposure to variable interest cash flows on the hedged item, i.e., CU50, exceeds the cumulative change in value of the hedging instrument, i.e., CU49.

Dr	Swap	CU49	
	Cr	Net assets/equity	CU49

If Entity A concludes that the hedge is no longer highly effective, it discontinues hedge accounting prospectively as from the date the hedge ceased to be highly effective in accordance with IPSAS 29.112.

Would the answer change if the fair value of the swap instead increases to CU51 of which CU50 results from the increase in market interest rates and CU1 from a decrease in the credit risk of the swap counterparty?

Yes. In this case, there is a credit to surplus or deficit of CU1 for the change in fair value of the swap attributable to the improvement in the credit quality of the swap counterparty. This is because the cumulative change in the value of the hedging instrument, i.e., CU51, exceeds the cumulative change in the present value of the future cash flows needed to offset the exposure to variable interest cash flows on the hedged item, i.e., CU50. The difference of CU1 represents the excess ineffectiveness attributable to the derivative hedging instrument, the swap, and is recognized in surplus or deficit.

Dr	Swap	CU51	
	Cr	Net assets/equity	CU50
	Cr	Surplus or deficit	CU1

F.5.3 Cash Flow Hedges: Performance of Hedging Instrument (2)

On September 30, 20X1, Entity A hedges the anticipated sale of 24 barrels of oil on March 1, 20X2 by entering into a short forward contract on 24 barrels of oil. The contract requires net settlement in cash determined as the difference between the future spot price of oil on a specified commodity exchange and CU1,000. Entity A expects to sell the oil in a different, local market. Entity A determines that the forward contract is an effective hedge of the anticipated sale and that the other conditions for hedge accounting are met. It assesses hedge effectiveness by comparing the entire change in the fair value of the forward contract with the change in the fair value of the expected cash inflows. On December 31, the spot price of oil has increased both in the local market and on the exchange. The increase in the local market exceeds the increase on the exchange. As a result, the present value of the

expected cash inflow from the sale on the local market is CU1,100. The fair value of Entity A's forward contract is negative CU80. Assuming that Entity A determines that the hedge is still highly effective, is there ineffectiveness that should be recognized in surplus or deficit?

No. In a cash flow hedge, ineffectiveness is not recognized in the financial statements when the cumulative change in the fair value of the hedged cash flows exceeds the cumulative change in the value of the hedging instrument. In this case, the cumulative change in the fair value of the forward contract is CU80, while the fair value of the cumulative change in expected future cash flows on the hedged item is CU100. Since the fair value of the cumulative change in expected future cash flows on the hedged item from the inception of the hedge exceeds the cumulative change in fair value of the hedging instrument (in absolute amounts), no portion of the gain or loss on the hedging instrument is recognized in surplus or deficit (IPSAS 29.106(b)). Because Entity A determines that the hedge relationship is still highly effective, it recognizes the entire change in fair value of the forward contract (CU80) in net assets/equity.

Dr	Net assets/equity	CU80	
	Cr Forward		CU80

If Entity A concludes that the hedge is no longer highly effective, it discontinues hedge accounting prospectively as from the date the hedge ceases to be highly effective in accordance with IPSAS 29.112.

F.5.4 Cash Flow Hedges: Forecast Transaction Occurs Before the Specified Period

An entity designates a derivative as a hedging instrument in a cash flow hedge of a forecast transaction, such as a forecast sale of a commodity. The hedging relationship meets all the hedge accounting conditions, including the requirement to identify and document the period in which the transaction is expected to occur within a reasonably specific and narrow range of time (see Question F.2.17). If, in a subsequent period, the forecast transaction is expected to occur in an earlier period than originally anticipated, can the entity conclude that this transaction is the same as the one that was designated as being hedged?

Yes. The change in timing of the forecast transaction does not affect the validity of the designation. However, it may affect the assessment of the effectiveness of the hedging relationship. Also, the hedging instrument would need to be designated as a hedging instrument for the whole remaining period of its existence in order for it to continue to qualify as a hedging instrument (see IPSAS 29.84 and Question F.2.17).

F.5.5 Cash Flow Hedges: Measuring Effectiveness for a Hedge of a Forecast Transaction in a Debt Instrument

A forecast investment in an interest-earning asset or forecast issue of an interest-bearing liability creates a cash flow exposure to interest rate changes

because the related interest payments will be based on the market rate that exists when the forecast transaction occurs. The objective of a cash flow hedge of the exposure to interest rate changes is to offset the effects of future changes in interest rates so as to obtain a single fixed rate, usually the rate that existed at the inception of the hedge that corresponds with the term and timing of the forecast transaction. During the period of the hedge, it is not possible to determine what the market interest rate for the forecast transaction will be at the time the hedge is terminated or when the forecast transaction occurs. In this case, how is the effectiveness of the hedge assessed and measured?

During this period, effectiveness can be measured on the basis of changes in interest rates between the designation date and the interim effectiveness measurement date. The interest rates used to make this measurement are the interest rates that correspond with the term and occurrence of the forecast transaction that existed at the inception of the hedge and that exist at the measurement date as evidenced by the term structure of interest rates.

Generally it will not be sufficient simply to compare cash flows of the hedged item with cash flows generated by the derivative hedging instrument as they are paid or received, since such an approach ignores the entity's expectations of whether the cash flows will offset in subsequent periods and whether there will be any resulting ineffectiveness.

The discussion that follows illustrates the mechanics of establishing a cash flow hedge and measuring its effectiveness. For the purpose of the illustrations, assume that an entity expects to issue a CU100,000 one-year debt instrument in three months. The instrument will pay interest quarterly with principal due at maturity. The entity is exposed to interest rate increases and establishes a hedge of the interest cash flows of the debt by entering into a forward starting interest rate swap. The swap has a term of one year and will start in three months to correspond with the terms of the forecast debt issue. The entity will pay a fixed rate and receive a variable rate, and the entity designates the risk being hedged as the LIBOR-based interest component in the forecast issue of the debt.

Yield Curve

The yield curve provides the foundation for computing future cash flows and the fair value of such cash flows both at the inception of, and during, the hedging relationship. It is based on current market yields on applicable reference bonds that are traded in the marketplace. Market yields are converted to spot interest rates ("spot rates" or "zero coupon rates") by eliminating the effect of coupon payments on the market yield. Spot rates are used to discount future cash flows, such as principal and interest rate payments, to arrive at their fair value. Spot rates also are used to compute forward interest rates that are used to compute variable and estimated future cash flows. The relationship between spot rates and one-period forward rates is shown by the following formula:

Spot-forward relationship

$$F = \frac{(1 + SR_t)^t}{(1 + SR_{t-1})^{t-1}} - 1$$

where

F = forward rate (%)

SR = spot rate (%)

t = period in time (e.g., 1, 2, 3, 4, 5)

Also, for the purpose of this illustration, assume that the following quarterly-period term structure of interest rates using quarterly compounding exists at the inception of the hedge.

Yield curve at inception – (beginning of period 1)					
<i>Forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
Spot rates	3.75%	4.50%	5.50%	6.00%	6.25%
Forward rates	3.75%	5.25%	7.51%	7.50%	7.25%

The one-period forward rates are computed on the basis of spot rates for the applicable maturities. For example, the current forward rate for Period 2 calculated using the formula above is equal to $[1.0450^2/1.0375] - 1 = 5.25$ percent. The current one-period forward rate for Period 2 is different from the current spot rate for Period 2, since the spot rate is an interest rate from the beginning of Period 1 (spot) to the end of Period 2, while the forward rate is an interest rate from the beginning of Period 2 to the end of Period 2.

Hedged Item

In this example, the entity expects to issue a CU100,000 one-year debt instrument in three months with quarterly interest payments. The entity is exposed to interest rate increases and would like to eliminate the effect on cash flows of interest rate changes that may happen before the forecast transaction takes place. If that risk is eliminated, the entity would obtain an interest rate on its debt issue that is equal to the one-year forward coupon rate currently available in the marketplace in three months. That forward coupon rate, which is different from the forward (spot) rate, is 6.86 percent, computed from the term structure of interest rates shown above. It is the market rate of interest that exists at the inception of the hedge, given the terms of the forecast debt instrument. It results in the fair value of the debt being equal to par at its issue.

At the inception of the hedging relationship, the expected cash flows of the debt instrument can be calculated on the basis of the existing term structure of interest rates. For this purpose, it is assumed that interest rates do not change and that the debt would be issued at 6.86 percent at the beginning of Period 2. In this case, the cash flows and fair value of the debt instrument would be as follows at the beginning of Period 2.

Issue of Fixed Rate Debt					
Beginning of period 2 - No rate changes (spot based on forward rates)					
<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
Spot rates		5.25%	6.38%	6.75%	6.88%
Forward rates		5.25%	7.51%	7.50%	7.25%
	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>
<i>Cash flows:</i>					
Fixed interest @6.86%		1,716	1,716	1,716	1,716
Principal					100,000
<i>Fair value:</i>					
Interest	6,592	1,694	1,663	1,632	1,603
Principal	93,408				93,408 ^(a)
Total	100,000				
^(a) $CU100,000 / (1 + [0.0688/4])^4$					

Since it is assumed that interest rates do not change, the fair value of the interest and principal amounts equals the par amount of the forecast transaction. The fair value amounts are computed on the basis of the spot rates that exist at the inception of the hedge for the applicable periods in which the cash flows would occur had the debt been issued at the date of the forecast transaction. They reflect the effect of discounting those cash flows on the basis of the periods that will remain after the debt instrument is issued. For example, the spot rate of 6.38 percent is used to discount the interest cash flow that is expected to be paid in Period 3, but it is discounted for only two periods because it will occur two periods after the forecast transaction.

The forward interest rates are the same as shown previously, since it is assumed that interest rates do not change. The spot rates are different but they have not actually changed. They represent the spot rates one period forward and are based on the applicable forward rates.

Hedging Instrument

The objective of the hedge is to obtain an overall interest rate on the forecast transaction and the hedging instrument that is equal to 6.86 percent, which is the market rate at the inception of the hedge for the period from Period 2 to Period 5. This objective is accomplished by entering into a forward starting interest rate swap

that has a fixed rate of 6.86 percent. Based on the term structure of interest rates that exist at the inception of the hedge, the interest rate swap will have such a rate. At the inception of the hedge, the fair value of the fixed rate payments on the interest rate swap will equal the fair value of the variable rate payments, resulting in the interest rate swap having a fair value of zero. The expected cash flows of the interest rate swap and the related fair value amounts are shown as follows.

Interest Rate Swap					
<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>
<i>Cash flows:</i>					
Fixed interest @6.86%		1,716	1,716	1,716	1,716
Forecast variable interest		1,313	1,877	1,876	1,813
<i>Forecast based on forward rate</i>		<i>5.25%</i>	<i>7.51%</i>	<i>7.50%</i>	<i>7.25%</i>
Net interest		(403)	161	160	97
<i>Fair value:</i>					
<i>Discount rate (spot)</i>		<i>5.25%</i>	<i>6.38%</i>	<i>6.75%</i>	<i>6.88%</i>
Fixed interest	6,592	1,694	1,663	1,632	1,603
Forecast variable interest	6,592	1,296	1,819	1,784	1,693
Fair value of interest rate swap	0	(398)	156	152	90

At the inception of the hedge, the fixed rate on the forward swap is equal to the fixed rate the entity would receive if it could issue the debt in three months under terms that exist today.

Measuring Hedge Effectiveness

If interest rates change during the period the hedge is outstanding, the effectiveness of the hedge can be measured in various ways.

Assume that interest rates change as follows immediately before the debt is issued at the beginning of Period 2.

Yield Curve - Rates Increase 200 Basis Points					
<i>Forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
Spot rates		5.75%	6.50%	7.50%	8.00%
Forward rates		5.75%	7.25%	9.51%	9.50%

Under the new interest rate environment, the fair value of the pay-fixed at 6.86 percent, receive-variable interest rate swap that was designated as the hedging instrument would be as follows.

Fair Value of Interest Rate Swap						
<i>Total</i>						
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>	
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	
	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>
<i>Cash flows:</i>						
Fixed interest @6.86%		1,716	1,716	1,716	1,716	
Forecast variable interest		1,438	1,813	2,377	2,376	
<i>Forecast based on new forward rate</i>		<i>5.25%</i>	<i>7.25%</i>	<i>9.51%</i>	<i>9.50%</i>	
Net interest		(279)	97	661	660	
<i>Fair value:</i>						
<i>New discount rate (spot)</i>		<i>5.75%</i>	<i>6.50%</i>	<i>7.50%</i>	<i>8.00%</i>	
Fixed interest	6,562	1,692	1,662	1,623	1,585	
Forecast variable interest	7,615	1,417	1,755	2,248	2,195	
Fair value of net interest	1,053	(275)	93	625	610	

In order to compute the effectiveness of the hedge, it is necessary to measure the change in the present value of the cash flows or the value of the hedged forecast transaction. There are at least two methods of accomplishing this measurement.

Method A Compute Change in Fair Value of Debt					
<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>	<i>CU</i>
<i>Cash flows:</i>					
Fixed interest @6.86%		1,716	1,716	1,716	1,716
Principal					100,000
<i>Fair value:</i>					
<i>New discount rate (spot)</i>		<i>5.75%</i>	<i>6.50%</i>	<i>7.50%</i>	<i>8.00%</i>
Interest	6,562	1,692	1,662	1,623	1,585
Principal	92,385				92,385 ^(a)
Total	98,947				
Fair value at inception	100,000				
Fair value difference	(1,053)				
CU100,000/(1 + [0.08/4]) ⁴					

Under Method A, a computation is made of the fair value in the new interest rate environment of debt that carries interest that is equal to the coupon interest rate that existed at the inception of the hedging relationship (6.86 percent). This fair value is compared with the expected fair value as of the beginning of Period 2 that was calculated on the basis of the term structure of interest rates that existed at the inception of the hedging relationship, as illustrated above, to determine the change in the fair value. Note that the difference between the change in the fair value of the swap and the change in the expected fair value of the debt exactly offset in this example, since the terms of the swap and the forecast transaction match each other.

Method B Compute Change in Fair Value of Cash Flows					
<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>		<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>
Market rate at inception		6.86%	6.86%	6.86%	6.86%
Current forward rate		5.75%	7.25%	9.51%	9.50%
Rate difference		1.11%	(0.39%)	(2.64%)	(2.64%)
Cash flow difference (principal × rate)		CU279	(CU97)	(CU661)	(CU660)
<i>Discount rate (spot)</i>		<i>5.75%</i>	<i>6.50%</i>	<i>7.50%</i>	<i>8.00%</i>
Fair value of difference	(CU1,053)	CU275	(CU93)	(CU625)	(CU610)

Under Method B, the present value of the change in cash flows is computed on the basis of the difference between the forward interest rates for the applicable periods at the effectiveness measurement date and the interest rate that would have been obtained if the debt had been issued at the market rate that existed at the inception of the hedge. The market rate that existed at the inception of the hedge is the one-year forward coupon rate in three months. The present value of the change in cash flows is computed on the basis of the current spot rates that exist at the effectiveness measurement date for the applicable periods in which the cash flows are expected to occur. This method also could be referred to as the “theoretical swap” method (or “hypothetical derivative” method) because the comparison is between the hedged fixed rate on the debt and the current variable rate, which is the same as comparing cash flows on the fixed and variable rate legs of an interest rate swap.

As before, the difference between the change in the fair value of the swap and the change in the present value of the cash flows exactly offset in this example, since the terms match.

Other Considerations

There is an additional computation that should be performed to compute ineffectiveness before the expected date of the forecast transaction that has not been considered for the purpose of this illustration. The fair value difference has been determined in each of the illustrations as of the expected date of the forecast transaction immediately before the forecast transaction, i.e., at the beginning of Period 2. If the assessment of hedge effectiveness is done before the forecast transaction occurs, the difference should be discounted to the current date to arrive at the actual amount of ineffectiveness. For example, if the measurement date were one month after the hedging relationship was established and the forecast transaction is now expected to occur in two months, the amount would have to be discounted for the remaining two months before the forecast transaction is expected to occur to arrive at the actual fair value. This step would not be necessary in the examples provided above because there was no ineffectiveness. Therefore, additional discounting of the amounts, which net to zero, would not have changed the result.

Under Method B, ineffectiveness is computed on the basis of the difference between the forward coupon interest rates for the applicable periods at the effectiveness measurement date and the interest rate that would have been obtained if the debt had been issued at the market rate that existed at the inception of the hedge. Computing the change in cash flows based on the difference between the forward interest rates that existed at the inception of the hedge and the forward rates that exist at the effectiveness measurement date is inappropriate if the objective of the hedge is to establish a single fixed rate for a series of forecast interest payments. This objective is met by hedging the exposures with an interest rate swap as illustrated in the above example. The fixed interest rate on the swap is a blended interest rate composed of the forward rates over the life of the swap. Unless the yield curve is flat, the comparison between the forward interest rate exposures over the life of the swap and

the fixed rate on the swap will produce different cash flows whose fair values are equal only at the inception of the hedging relationship. This difference is shown in the table below.

<i>Total</i>					
<i>Original forward periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>5</i>
<i>Remaining periods</i>	<i>1</i>	<i>2</i>	<i>3</i>	<i>4</i>	<i>4</i>
Forward rate at inception		5.25%	7.51%	7.50%	7.25%
Current forward rate		5.75%	7.25%	9.51%	9.50%
Rate difference		(0.50%)	0.26%	(2.00%)	(2.25%)
Cash flow difference (principal × rate)		(CU125)	CU64	(CU501)	(CU563)
Discount rate (spot)		5.75%	6.50%	7.50%	8.00%
Fair value of difference	(CU1,055)	(CU123)	CU62	(CU474)	(CU520)
Fair value of interest rate swap	CU1,053				
Ineffectiveness	(CU2)				

If the objective of the hedge is to obtain the forward rates that existed at the inception of the hedge, the interest rate swap is ineffective because the swap has a single blended fixed coupon rate that does not offset a series of different forward interest rates. However, if the objective of the hedge is to obtain the forward coupon rate that existed at the inception of the hedge, the swap is effective, and the comparison based on differences in forward interest rates suggests ineffectiveness when none may exist. Computing ineffectiveness based on the difference between the forward interest rates that existed at the inception of the hedge and the forward rates that exist at the effectiveness measurement date would be an appropriate measurement of ineffectiveness if the hedging objective is to lock in those forward interest rates. In that case, the appropriate hedging instrument would be a series of forward contracts each of which matures on a repricing date that corresponds with the date of the forecast transactions.

It also should be noted that it would be inappropriate to compare only the variable cash flows on the interest rate swap with the interest cash flows in the debt that would be generated by the forward interest rates. That methodology has the effect of measuring ineffectiveness only on a portion of the derivative, and IPSAS 29 does not permit the bifurcation of a derivative for the purposes of assessing effectiveness in this situation (IPSAS 29.83). It is recognized, however, that if the fixed interest rate on the interest rate swap is equal to the fixed rate that would have been obtained on the debt at inception, there will be no ineffectiveness assuming that there are no differences in terms and no change in credit risk or it is not designated in the hedging relationship.

F.5.6 Cash Flow Hedges: Firm Commitment to Purchase Property, Plant and Equipment in a Foreign Currency

Entity A has the Local Currency (LC) as its functional currency and presentation currency. On June 30, 20X1, it enters into a forward exchange contract to receive Foreign Currency (FC) 100,000 and deliver LC109,600 on June 30, 20X2 at an initial cost and fair value of zero. It designates the forward exchange contract as a hedging instrument in a cash flow hedge of a firm commitment to purchase spare parts for its electricity distribution network on March 31, 20X2 and the resulting payable of FC100,000, which is to be paid on June 30, 20X2. All hedge accounting conditions in IPSAS 29 are met.

As indicated in the table below, on June 30, 20X1, the spot exchange rate is LC1.072 to FC1, while the twelve-month forward exchange rate is LC1.096 to FC1. On December 31, 20X1, the spot exchange rate is LC1.080 to FC1, while the six-month forward exchange rate is LC1.092 to FC1. On March 31, 20X2, the spot exchange rate is LC1.074 to FC1, while the three-month forward rate is LC1.076 to FC1. On June 30, 20X2, the spot exchange rate is LC1.072 to FC1. The applicable yield curve in the local currency is flat at 6 percent per year throughout the period. The fair value of the forward exchange contract is negative LC388 on December 31, 20X1 $\{([1.092 \times 100,000] - 109,600)/1.06(6/12)\}$, negative LC1,971 on March 31, 20X2 $\{([1.076 \times 100,000] - 109,600)/1.06(3/12)\}$, and negative LC2,400 on June 30, 20X2 $\{1.072 \times 100,000 - 109,600\}$.

Date	Spot rate	Forward rate to June 30, 20X2	Fair value of forward contract
June 30, 20X1	1.072	1.096	–
December 31, 20X1	1.080	1.092	(388)
March 31, 20X2	1.074	1.076	(1,971)
June 30, 20X2	1.072	–	(2,400)

Issue (a) – What is the accounting for these transactions if the hedging relationship is designated as being for changes in the fair value of the forward exchange contract and the entity's accounting policy is to apply basis adjustment to non-financial assets that result from hedged forecast transactions?

The accounting entries are as follows.

June 30, 20X1

Dr	Forward	LC0	
	Cr	Cash	LC0

To record the forward exchange contract at its initial amount of zero (IPSAS 29.45). The hedge is expected to be fully effective because the critical terms of the forward exchange contract and the purchase contract and the assessment of hedge effectiveness are based on the forward price (IPSAS 29.AG149).

December 31, 20X1

Dr	Net assets/equity	LC388	
	Cr	Forward liability	LC388

To record the change in the fair value of the forward exchange contract between June 30, 20X1 and December 31, 20X1, i.e., $LC388 - 0 = LC388$, in net assets/equity (IPSAS 29.106). The hedge is fully effective because the loss on the forward exchange contract (LC388) exactly offsets the change in cash flows associated with the purchase contract based on the forward price $[(LC388) = \{([1.092 \times 100,000] - 109,600)/1.06(6/12)\} - \{([1.096 \times 100,000] - 109,600)/1.06\}]$

March 31, 20X2

Dr	Net assets/equity	LC1,583	
	Cr	Forward liability	LC1,583

To record the change in the fair value of the forward exchange contract between January 1, 20X2 and March 31, 20X2 (i.e., $LC1,971 - LC388 = LC1,583$) in net assets/equity (IPSAS 29.106). The hedge is fully effective because the loss on the forward exchange contract (LC1,583) exactly offsets the change in cash flows associated with the purchase contract based on the forward price $[(LC1,583) = \{([1.076 \times 100,000] - 109,600)/1.06(3/12)\} - \{([1.092 \times 100,000] - 109,600)/1.06(6/12)\}]$

Dr	Property, plant and equipment (purchase price)	LC107,400	
Dr	Property, plant and equipment (hedging loss)	LC1,971	
	Cr	Net assets/equity	LC1,971
	Cr	Payable	LC107,400

To recognize the purchase of the spare parts at the spot rate ($1.074 \times FC100,000$) and remove the cumulative loss on the forward exchange contract that has been recognized in net assets/equity (LC1,971) and include it in the initial measurement of the spare parts purchased. Accordingly, the initial measurement of the is LC109,371 consisting of a purchase consideration of LC107,400 and a hedging loss of LC1,971.

June 30, 20X2

Dr	Payable	LC107,400	
	Cr	Cash	LC107,200
	Cr	Surplus or deficit	LC200

To record the settlement of the payable at the spot rate ($FC100,000 \times 1.072 = 107,200$) and the associated exchange gain of LC200 ($LC107,400 - LC107,200$).

Dr	Surplus or deficit	LC429	
	Cr	Forward liability	LC429

To record the loss on the forward exchange contract between April 1, 20X2 and June 30, 20X2 (i.e., $LC2,400 - LC1,971 = LC429$) in surplus or deficit. The hedge is regarded as fully effective because the loss on the forward exchange contract (LC429) exactly offsets the change in the fair value of the payable based on the forward price ($LC429 = ([1.072 \times 100,000] - 109,600 - \{([1.076 \times 100,000] - 109,600)/1.06(3/12)\})$).

Dr	Forward liability	LC2,400	
	Cr	Cash	LC2,400

To record the net settlement of the forward exchange contract.

Issue (b) – What is the accounting for these transactions if the hedging relationship instead is designated as being for changes in the spot element of the forward exchange contract and the interest element is excluded from the designated hedging relationship (IPSAS 29.83)?

The accounting entries are as follows.

June 30, 20X1

Dr	Forward	LC0	
	Cr	Cash	LC0

To record the forward exchange contract at its initial amount of zero (IPSAS 29.45). The hedge is expected to be fully effective because the critical terms of the forward exchange contract and the purchase contract are the same and the change in the premium or discount on the forward contract is excluded from the assessment of effectiveness (IPSAS 29.AG149).

December 31, 20X1

Dr	Surplus or deficit (interest element)	LC1,165	
	Cr	Net assets/equity (spot element)	LC777
	Cr	Forward liability	LC388

To record the change in the fair value of the forward exchange contract between June 30, 20X1 and December 31, 20X1, i.e., $LC388 - 0 = LC388$. The change in the present value of spot settlement of the forward exchange contract is a gain of LC777 ($\{([1.080 \times 100,000] - 107,200)/1.06(6/12)\} - \{([1.072 \times 100,000] - 107,200)/1.06\}$), which is recognized in net assets/equity (IPSAS 29.106). The change in the interest element of the forward exchange contract (the residual change in fair value) is a loss of LC1,165 ($388 + 777$), which is recognized in surplus or deficit (IPSAS 29.83 and IPSAS 29.64(a)). The hedge is fully effective because the gain in the spot element of the forward contract (LC777) exactly offsets the change in the purchase price at spot rates ($LC777 = \{([1.080 \times 100,000] - 107,200)/1.06(6/12)\} - \{([1.072 \times 100,000] - 107,200)/1.06\}$).

March 31, 20X2

Dr	Net assets/equity (spot element)	LC580	
Dr	Surplus or deficit (interest element)	LC1,003	
Cr	Forward liability		LC1,583

To record the change in the fair value of the forward exchange contract between January 1, 20X2 and March 31, 20X2, i.e., $LC1,971 - LC388 = LC1,583$. The change in the present value of the spot settlement of the forward exchange contract is a loss of LC580 ($\{([1.074 \times 100,000] - 107,200)/1.06(3/12)\} - \{([1.080 \times 100,000] - 107,200)/1.06(6/12)\}$), which is recognized in net assets/equity (IPSAS 29.106(a)). The change in the interest element of the forward exchange contract (the residual change in fair value) is a loss of LC1,003 ($LC1,583 - LC580$), which is recognized in surplus or deficit (IPSAS 29.83 and IPSAS 29.,64(a)). The hedge is fully effective because the loss in the spot element of the forward contract (LC580) exactly offsets the change in the purchase price at spot rates $\{580\} = \{([1.074 \times 100,000] - 107,200)/1.06(3/12)\} - \{([1.080 \times 100,000] - 107,200)/1.06(6/12)\}$.

Dr	Property, plant and equipment (purchase price)	LC107,400	
Dr	Net assets/equity	LC197	
Cr	Property, plant and equipment (hedging gain)		LC197
Cr	Payable		LC107,400

To recognize the purchase of spare parts at the spot rate ($= 1.074 \times FC100,000$) and remove the cumulative gain on the spot element of the forward exchange contract that has been recognized in net assets/equity ($LC777 - LC580 = LC197$) and include it in the initial measurement of the spare parts. Accordingly, the initial measurement of the spare parts is LC107,203, consisting of a purchase consideration of LC107,400 and a hedging gain of LC197.

June 30, 20X2

Dr	Payable	LC107,400	
Cr	Cash		LC107,200
Cr	Surplus or deficit		LC200

To record the settlement of the payable at the spot rate ($FC100,000 \times 1.072 = LC107,200$) and the associated exchange gain of LC200 ($- [1.072 - 1.074] \times FC100,000$).

Dr	Surplus or deficit (spot element)	LC197	
Dr	Surplus or deficit (interest element)	LC232	
Cr	Forward liability		LC429

To record the change in the fair value of the forward exchange contract between April 1, 20X2 and June 30, 20X2 (i.e., LC2,400 – LC1,971 = LC429). The change in the present value of the spot settlement of the forward exchange contract is a loss of LC197 ($\{[1.072 \times 100,000] - 107,200 - \{([1.074 \times 100,000] - 107,200)/1.06(3/12)\}\}$), which is recognized in surplus or deficit. The change in the interest element of the forward exchange contract (the residual change in fair value) is a loss of LC232 (LC429 – LC197), which is recognized in surplus or deficit. The hedge is fully effective because the loss in the spot element of the forward contract (LC197) exactly offsets the change in the present value of the spot settlement of the payable [$LC197 = \{[1.072 \times 100,000] - 107,200 - \{([1.074 \times 100,000] - 107,200)/1.06(3/12)\}\}$].

Dr	Forward liability	LC2,400	
Cr	Cash		LC2,400

To record the net settlement of the forward exchange contract.

The following table provides an overview of the components of the change in fair value of the hedging instrument over the term of the hedging relationship. It illustrates that the way in which a hedging relationship is designated affects the subsequent accounting for that hedging relationship, including the assessment of hedge effectiveness and the recognition of gains and losses.

Period ending	Change in spot settlement	Fair value of change in spot settlement	Change in forward settlement	Fair value of change in forward settlement	Fair value of change in interest element
	LC	LC	LC	LC	LC
June 20X1	–	–	–	–	–
December 20X1	800	777	(400)	(388)	(1,165)
March 20X2	(600)	(580)	(1,600)	(1,583)	(1,003)
June 20X2	(200)	(197)	(400)	(429)	(232)
Total	–	–	(2,400)	(2,400)	(2,400)

F.6 Hedges: Other Issues

F.6.1 Hedge Accounting: Management of Interest Rate Risk in Entities Such as Departments of Finance

Entities, such as departments of finance, often manage their exposure to interest rate risk on a net basis for all or parts of their activities. They have systems to accumulate critical information throughout the entity about their financial assets, financial liabilities and forward commitments, including loan commitments. This information is used to estimate and aggregate cash flows and to schedule such estimated cash flows into the applicable future periods in

which they are expected to be paid or received. The systems generate estimates of cash flows based on the contractual terms of the instruments and other factors, including estimates of prepayments and defaults. For risk management purposes, many entities use derivative contracts to offset some or all exposure to interest rate risk on a net basis.

If an entity manages interest rate risk on a net basis, can its activities potentially qualify for hedge accounting under IPSAS 29?

Yes. However, to qualify for hedge accounting the derivative hedging instrument that hedges the net position for risk management purposes must be designated for accounting purposes as a hedge of a gross position related to assets, liabilities, forecast cash inflows or forecast cash outflows giving rise to the net exposure (IPSAS 29.94, IPSAS 29.AG141 and IPSAS 29.AG154). It is not possible to designate a net position as a hedged item under IPSAS 29 because of the inability to associate hedging gains and losses with a specific item being hedged and, correspondingly, to determine objectively the period in which such gains and losses should be recognized in surplus or deficit.

Hedging a net exposure to interest rate risk can often be defined and documented to meet the qualifying criteria for hedge accounting in IPSAS 29.98 if the objective of the activity is to offset a specific, identified and designated risk exposure that ultimately affects the entity's surplus or deficit (IPSAS 29.AG153) and the entity designates and documents its interest rate risk exposure on a gross basis. Also, to qualify for hedge accounting the information systems must capture sufficient information about the amount and timing of cash flows and the effectiveness of the risk management activities in accomplishing their objective.

The factors an entity must consider for hedge accounting purposes if it manages interest rate risk on a net basis are discussed in Question F.6.2.

F.6.2 Hedge Accounting Considerations when Interest Rate Risk is Managed on a Net Basis

If an entity manages its exposure to interest rate risk on a net basis, what are the issues the entity should consider in defining and documenting its interest rate risk management activities to qualify for hedge accounting and in establishing and accounting for the hedge relationship?

Issues (a) – (l) below deal with the main issues. First, Issues (a) and (b) discuss the designation of derivatives used in interest rate risk management activities as fair value hedges or cash flow hedges. As noted there, hedge accounting criteria and accounting consequences differ between fair value hedges and cash flow hedges. Since it may be easier to achieve hedge accounting treatment if derivatives used in interest rate risk management activities are designated as cash flow hedging instruments, Issues (c) – (l) expand on various aspects of the accounting for cash flow hedges. Issues (c) – (f) consider the application of the hedge accounting criteria for cash flow hedges in IPSAS 29, and Issues (g) and (h) discuss the required

accounting treatment. Finally, Issues (i) – (l) elaborate on other specific issues relating to the accounting for cash flow hedges.

Issue (a) – Can a derivative that is used to manage interest rate risk on a net basis be designated under IPSAS 29 as a hedging instrument in a fair value hedge or a cash flow hedge of a gross exposure?

Both types of designation are possible under IPSAS 29. An entity may designate the derivative used in interest rate risk management activities either as a fair value hedge of assets, liabilities and firm commitments or as a cash flow hedge of forecast transactions, such as the anticipated reinvestment of cash inflows, the anticipated refinancing or rollover of a financial liability, and the cash flow consequences of the resetting of interest rates for an asset or a liability.

In economic terms, it does not matter whether the derivative instrument is regarded as a fair value hedge or as a cash flow hedge. Under either perspective of the exposure, the derivative has the same economic effect of reducing the net exposure. For example, a receive-fixed, pay-variable interest rate swap can be considered to be a cash flow hedge of a variable rate asset or a fair value hedge of a fixed rate liability. Under either perspective, the fair value or cash flows of the interest rate swap offset the exposure to interest rate changes. However, accounting consequences differ depending on whether the derivative is designated as a fair value hedge or a cash flow hedge, as discussed in Issue (b).

To illustrate: a department of finance has the following assets and liabilities with a maturity of two years.

	Variable interest	Fixed interest
	CU	CU
Assets	60	100
Liabilities	(100)	(60)
Net	<u>(40)</u>	<u>40</u>

The entity takes out a two-year swap with a notional principal of CU40 to receive a variable interest rate and pay a fixed interest rate to hedge the net exposure. As discussed above, this may be regarded and designated either as a fair value hedge of CU40 of the fixed rate assets or as a cash flow hedge of CU40 of the variable rate liabilities.

Issue (b) – What are the critical considerations in deciding whether a derivative that is used to manage interest rate risk on a net basis should be designated as a hedging instrument in a fair value hedge or a cash flow hedge of a gross exposure?

Critical considerations include the assessment of hedge effectiveness in the presence of prepayment risk and the ability of the information systems to attribute fair value or cash flow changes of hedging instruments to fair value or cash flow changes, respectively, of hedged items, as discussed below.

For accounting purposes, the designation of a derivative as hedging a fair value exposure or a cash flow exposure is important because both the qualification requirements for hedge accounting and the recognition of hedging gains and losses for these categories are different. It is often easier to demonstrate high effectiveness for a cash flow hedge than for a fair value hedge.

Effects of Prepayments

Prepayment risk inherent in many financial instruments affects the fair value of an instrument and the timing of its cash flows and impacts on the effectiveness test for fair value hedges and the highly probable test for cash flow hedges, respectively.

Effectiveness is often more difficult to achieve for fair value hedges than for cash flow hedges when the instrument being hedged is subject to prepayment risk. For a fair value hedge to qualify for hedge accounting, the changes in the fair value of the derivative hedging instrument must be expected to be highly effective in offsetting the changes in the fair value of the hedged item (IPSAS 29.98(b)). This test may be difficult to meet if, for example, the derivative hedging instrument is a forward contract having a fixed term and the financial assets being hedged are subject to prepayment by the borrower. Also, it may be difficult to conclude that, for a portfolio of fixed rate assets that are subject to prepayment, the changes in the fair value for each individual item in the group will be expected to be approximately proportional to the overall changes in fair value attributable to the hedged risk of the group. Even if the risk being hedged is a benchmark interest rate, to be able to conclude that fair value changes will be proportional for each item in the portfolio, it may be necessary to disaggregate the asset portfolio into categories based on term, coupon, credit, type of loan and other characteristics.

In economic terms, a forward derivative instrument could be used to hedge assets that are subject to prepayment but it would be effective only for small movements in interest rates. A reasonable estimate of prepayments can be made for a given interest rate environment and the derivative position can be adjusted as the interest rate environment changes. If an entity's risk management strategy is to adjust the amount of the hedging instrument periodically to reflect changes in the hedged position, the entity needs to demonstrate that the hedge is expected to be highly effective only for the period until the amount of the hedging instrument is next adjusted. However, for that period, the expectation of effectiveness has to be based on existing fair value exposures and the potential for interest rate movements without consideration of future adjustments to those positions. Furthermore, the fair value exposure attributable to prepayment risk can generally be hedged with options.

For a cash flow hedge to qualify for hedge accounting, the forecast cash flows, including the reinvestment of cash inflows or the refinancing of cash outflows, must be highly probable (IPSAS 29.98(c) and the hedge expected to be highly effective in achieving offsetting changes in the cash flows of the hedged item and hedging instrument (IPSAS 29.98(b)). Prepayments affect the timing of cash flows and, therefore, the probability of occurrence of the forecast transaction. If the hedge is

established for risk management purposes on a net basis, an entity may have sufficient levels of highly probable cash flows on a gross basis to support the designation for accounting purposes of forecast transactions associated with a portion of the gross cash flows as the hedged item. In this case, the portion of the gross cash flows designated as being hedged may be chosen to be equal to the amount of net cash flows being hedged for risk management purposes.

Systems Considerations

The accounting for fair value hedges differs from that for cash flow hedges. It is usually easier to use existing information systems to manage and track cash flow hedges than it is for fair value hedges.

Under fair value hedge accounting, the assets or liabilities that are designated as being hedged are remeasured for those changes in fair values during the hedge period that are attributable to the risk being hedged. Such changes adjust the carrying amount of the hedged items and, for interest sensitive assets and liabilities, may result in an adjustment of the effective interest rate of the hedged item (IPSAS 29.99). As a consequence of fair value hedging activities, the changes in fair value have to be allocated to the assets or liabilities being hedged in order for the entity to be able to recompute their effective interest rate, determine the subsequent amortization of the fair value adjustment to surplus or deficit, and determine the amount that should be recognized in surplus or deficit when assets are sold or liabilities extinguished (IPSAS 29.99 and IPSAS 29.103). To comply with the requirements for fair value hedge accounting, it will generally be necessary to establish a system to track the changes in the fair value attributable to the hedged risk, associate those changes with individual hedged items, recompute the effective interest rate of the hedged items, and amortize the changes to surplus or deficit over the life of the respective hedged item.

Under cash flow hedge accounting, the cash flows relating to the forecast transactions that are designated as being hedged reflect changes in interest rates. The adjustment for changes in the fair value of a hedging derivative instrument is initially recognized in net assets/equity (IPSAS 29.105). To comply with the requirements for cash flow hedge accounting, it is necessary to determine when the cumulative gains and losses recognized in net assets/equity from changes in the fair value of a hedging instrument should be recognized in surplus or deficit (IPSAS 29.111 and IPSAS 29.112). For cash flow hedges, it is not necessary to create a separate system to make this determination. The system used to determine the extent of the net exposure provides the basis for scheduling the changes in the cash flows of the derivative and the recognition of such changes in surplus or deficit.

The timing of the recognition in surplus or deficit can be predetermined when the hedge is associated with the exposure to changes in cash flows. The forecast transactions that are being hedged can be associated with a specific principal amount in specific future periods composed of variable rate assets and cash inflows being reinvested or variable rate liabilities and cash outflows being refinanced, each of

which creates a cash flow exposure to changes in interest rates. The specific principal amounts in specific future periods are equal to the notional amount of the derivative hedging instruments and are hedged only for the period that corresponds to the repricing or maturity of the derivative hedging instruments so that the cash flow changes resulting from changes in interest rates are matched with the derivative hedging instrument. IPSAS 29.111 specifies that the amounts recognized in net assets/equity should be recognized in surplus or deficit in the same period or periods during which the hedged item affects surplus or deficit.

Issue (c) – If a hedging relationship is designated as a cash flow hedge relating to changes in cash flows resulting from interest rate changes, what would be included in the documentation required by IPSAS 29.98(a)?

The following would be included in the documentation.

The hedging relationship – The maturity schedule of cash flows used for risk management purposes to determine exposures to cash flow mismatches on a net basis would provide part of the documentation of the hedging relationship.

The entity's risk management objective and strategy for undertaking the hedge – The entity's overall risk management objective and strategy for hedging exposures to interest rate risk would provide part of the documentation of the hedging objective and strategy.

The type of hedge – The hedge is documented as a cash flow hedge.

The hedged item – The hedged item is documented as a group of forecast transactions (interest cash flows) that are expected to occur with a high degree of probability in specified future periods, for example, scheduled on a monthly basis. The hedged item may include interest cash flows resulting from the reinvestment of cash inflows, including the resetting of interest rates on assets, or from the refinancing of cash outflows, including the resetting of interest rates on liabilities and rollovers of financial liabilities. As discussed in Issue (e), the forecast transactions meet the probability test if there are sufficient levels of highly probable cash flows in the specified future periods to encompass the amounts designated as being hedged on a gross basis.

The hedged risk – The risk designated as being hedged is documented as a portion of the overall exposure to changes in a specified market interest rate, often the risk-free interest rate or an interbank offered rate, common to all items in the group. To help ensure that the hedge effectiveness test is met at inception of the hedge and subsequently, the designated hedged portion of the interest rate risk could be documented as being based on the same yield curve as the derivative hedging instrument.

The hedging instrument – Each derivative hedging instrument is documented as a hedge of specified amounts in specified future time periods corresponding with the forecast transactions occurring in the specified future time periods designated as being hedged.

The method of assessing effectiveness – The effectiveness test is documented as being measured by comparing the changes in the cash flows of the derivatives allocated to the applicable periods in which they are designated as a hedge to the changes in the cash flows of the forecast transactions being hedged. Measurement of the cash flow changes is based on the applicable yield curves of the derivatives and hedged items.

Issue (d) – If the hedging relationship is designated as a cash flow hedge, how does an entity satisfy the requirement for an expectation of high effectiveness in achieving offsetting changes in IPSAS 29.98(b)?

An entity may demonstrate an expectation of high effectiveness by preparing an analysis demonstrating high historical and expected future correlation between the interest rate risk designated as being hedged and the interest rate risk of the hedging instrument. Existing documentation of the hedge ratio used in establishing the derivative contracts may also serve to demonstrate an expectation of effectiveness.

Issue (e) – If the hedging relationship is designated as a cash flow hedge, how does an entity demonstrate a high probability of the forecast transactions occurring as required by IPSAS 29.98(c)?

An entity may do this by preparing a cash flow maturity schedule showing that there exist sufficient aggregate gross levels of expected cash flows, including the effects of the resetting of interest rates for assets or liabilities, to establish that the forecast transactions that are designated as being hedged are highly probable to occur. Such a schedule should be supported by management's stated intentions and past practice of reinvesting cash inflows and refinancing cash outflows.

For example, an entity may forecast aggregate gross cash inflows of CU100 and aggregate gross cash outflows of CU90 in a particular time period in the near future. In this case, it may wish to designate the forecast reinvestment of gross cash inflows of CU10 as the hedged item in the future time period. If more than CU10 of the forecast cash inflows are contractually specified and have low credit risk, the entity has strong evidence to support an assertion that gross cash inflows of CU10 are highly probable to occur and to support the designation of the forecast reinvestment of those cash flows as being hedged for a particular portion of the reinvestment period. A high probability of the forecast transactions occurring may also be demonstrated under other circumstances.

Issue (f) – If the hedging relationship is designated as a cash flow hedge, how does an entity assess and measure effectiveness under IPSAS 29.98(d) and IPSAS 29.98(e)?

Effectiveness is required to be measured at a minimum at the time an entity prepares its annual or interim financial reports. However, an entity may wish to measure it more frequently on a specified periodic basis, at the end of each month or other applicable reporting period. It is also measured whenever derivative positions

designated as hedging instruments are changed or hedges are terminated to ensure that the recognition in surplus or deficit of the changes in the fair value amounts on assets and liabilities and the recognition of changes in the fair value of derivative instruments designated as cash flow hedges are appropriate.

Changes in the cash flows of the derivative are computed and allocated to the applicable periods in which the derivative is designated as a hedge and are compared with computations of changes in the cash flows of the forecast transactions. Computations are based on yield curves applicable to the hedged items and the derivative hedging instruments and applicable interest rates for the specified periods being hedged.

The schedule used to determine effectiveness could be maintained and used as the basis for determining the period in which the hedging gains and losses recognized initially in net assets/equity are recognized in surplus or deficit.

Issue (g) – If the hedging relationship is designated as a cash flow hedge, how does an entity account for the hedge?

The hedge is accounted for as a cash flow hedge in accordance with the provisions in IPSAS 29.106–IPSAS 29.111, as follows:

- (a) The portion of gains and losses on hedging derivatives determined to result from effective hedges is recognized in net assets/equity whenever effectiveness is measured; and
- (b) The ineffective portion of gains and losses resulting from hedging derivatives is recognized in surplus or deficit.

IPSAS 29.111 specifies that the amounts recognized in net assets/equity should be recognized in surplus or deficit in the same period or periods during which the hedged item affects surplus or deficit. Accordingly, when the forecast transactions occur, the amounts previously recognized in net assets/equity are recognized in surplus or deficit. For example, if an interest rate swap is designated as a hedging instrument of a series of forecast cash flows, the changes in the cash flows of the swap are removed from net assets/equity and recognized in surplus or deficit in the periods when the forecast cash flows and the cash flows of the swap offset each other.

Issue (h) – If the hedging relationship is designated as a cash flow hedge, what is the treatment of any net cumulative gains and losses recognized in net assets/equity if the hedging instrument is terminated prematurely, the hedge accounting criteria are no longer met, or the hedged forecast transactions are no longer expected to take place?

If the hedging instrument is terminated prematurely or the hedge no longer meets the criteria for qualification for hedge accounting, for example, the forecast transactions are no longer highly probable, the net cumulative gain or loss recognized in net assets/equity remains in net assets/equity until the forecast transaction occurs (IPSAS

29.112(a) and IPSAS 29.112(b)). If the hedged forecast transactions are no longer expected to occur, the net cumulative gain or loss is recognized in surplus or deficit (IPSAS 29.112(c)).

Issue (i) – IPSAS 29.84 states that a hedging relationship may not be designated for only a portion of the time period in which a hedging instrument is outstanding. If the hedging relationship is designated as a cash flow hedge, and the hedge subsequently fails the test for being highly effective, does IPSAS 29.84 preclude redesignating the hedging instrument?

No. IPSAS 29.84 indicates that a derivative instrument may not be designated as a hedging instrument for only a portion of its remaining period to maturity. IPSAS 29.84 does not refer to the derivative instrument's original period to maturity. If there is a hedge effectiveness failure, the ineffective portion of the gain or loss on the derivative instrument is recognized immediately in surplus or deficit (IPSAS 29.106) and hedge accounting based on the previous designation of the hedge relationship cannot be continued (IPSAS 29.112). In this case, the derivative instrument may be redesignated prospectively as a hedging instrument in a new hedging relationship provided this hedging relationship satisfies the necessary conditions. The derivative instrument must be redesignated as a hedge for the entire time period it remains outstanding.

Issue (j) – For cash flow hedges, if a derivative is used to manage a net exposure to interest rate risk and the derivative is designated as a cash flow hedge of forecast interest cash flows or portions of them on a gross basis, does the occurrence of the hedged forecast transaction give rise to an asset or liability that will result in a portion of the hedging gains and losses that were recognized in net assets/equity remaining in net assets/equity?

No. In the hedging relationship described in Issue (c) above, the hedged item is a group of forecast transactions consisting of interest cash flows in specified future periods. The hedged forecast transactions do not result in the recognition of assets or liabilities and the effect of interest rate changes that are designated as being hedged is recognized in surplus or deficit in the period in which the forecast transactions occur. Although this is not relevant for the types of hedges described here, if instead the derivative is designated as a hedge of a forecast purchase of a financial asset or issue of a financial liability, the associated gains or losses that were recognized in net assets/equity are recognized in surplus or deficit in the same period or periods during which the hedged forecast transaction affects surplus or deficit (such as in the periods that interest expenses are recognized). However, if an entity expects at any time that all or a portion of a net loss recognized net assets/equity will not be recovered in one or more future periods, it shall reclassify immediately into surplus or deficit the amount that is not expected to be recovered.

Issue (k) – In the answer to Issue (c) above it was indicated that the designated hedged item is a portion of a cash flow exposure. Does IPSAS 29 permit a portion of a cash flow exposure to be designated as a hedged item?

Yes. IPSAS 29 does not specifically address a hedge of a portion of a cash flow exposure for a forecast transaction. However, IPSAS 29.90 specifies that a financial asset or liability may be a hedged item with respect to the risks associated with only a portion of its cash flows or fair value, if effectiveness can be measured. The ability to hedge a portion of a cash flow exposure resulting from the resetting of interest rates for assets and liabilities suggests that a portion of a cash flow exposure resulting from the forecast reinvestment of cash inflows or the refinancing or rollover of financial liabilities can also be hedged. The basis for qualification as a hedged item of a portion of an exposure is the ability to measure effectiveness. This is further supported by IPSAS 29.92, which specifies that a non-financial asset or liability can be hedged only in its entirety or for foreign currency risk but not for a portion of other risks because of the difficulty of isolating and measuring the appropriate portion of the cash flows or fair value changes attributable to a specific risk. Accordingly, assuming effectiveness can be measured, a portion of a cash flow exposure of forecast transactions associated with, for example, the resetting of interest rates for a variable rate asset or liability can be designated as a hedged item.

Issue (l) – In the answer to Issue (c) above it was indicated that the hedged item is documented as a group of forecast transactions. Since these transactions will have different terms when they occur, including credit exposures, maturities and option features, how can an entity satisfy the tests in IPSAS 29.87 and IPSAS 29.93 requiring the hedged group to have similar risk characteristics?

IPSAS 29.87 provides for hedging a group of assets, liabilities, firm commitments or forecast transactions with similar risk characteristics. IPSAS 29.93 provides additional guidance and specifies that portfolio hedging is permitted if two conditions are met, namely: the individual items in the portfolio share the same risk for which they are designated, and the change in the fair value attributable to the hedged risk for each individual item in the group will be expected to be approximately proportional to the overall change in fair value.

When an entity associates a derivative hedging instrument with a gross exposure, the hedged item typically is a group of forecast transactions. For hedges of cash flow exposures relating to a group of forecast transactions, the overall exposure of the forecast transactions and the assets or liabilities that are repriced may have very different risks. The exposure from forecast transactions may differ depending on the terms that are expected as they relate to credit exposures, maturities, options and other features. Although the overall risk exposures may be different for the individual items in the group, a specific risk inherent in each of the items in the group can be designated as being hedged.

The items in the portfolio do not necessarily have to have the same overall exposure to risk, provided they share the same risk for which they are designated as being

hedged. A common risk typically shared by a portfolio of financial instruments is exposure to changes in the risk-free or benchmark interest rate or to changes in a specified rate that has a credit exposure equal to the highest credit-rated instrument in the portfolio (i.e., the instrument with the lowest credit risk). If the instruments that are grouped into a portfolio have different credit exposures, they may be hedged as a group for a portion of the exposure. The risk they have in common that is designated as being hedged is the exposure to interest rate changes from the highest credit rated instrument in the portfolio. This ensures that the change in fair value attributable to the hedged risk for each individual item in the group is expected to be approximately proportional to the overall change in fair value attributable to the hedged risk of the group. It is likely there will be some ineffectiveness if the hedging instrument has a credit quality that is inferior to the credit quality of the highest credit-rated instrument being hedged, since a hedging relationship is designated for a hedging instrument in its entirety (IPSAS 29.83). For example, if a portfolio of assets consists of assets rated A, BB and B, and the current market interest rates for these assets are LIBOR+20 basis points, LIBOR+40 basis points and LIBOR+60 basis points, respectively, an entity may use a swap that pays fixed interest rate and for which variable interest payments based on LIBOR are made to hedge the exposure to variable interest rates. If LIBOR is designated as the risk being hedged, credit spreads above LIBOR on the hedged items are excluded from the designated hedge relationship and the assessment of hedge effectiveness.

F.6.3 Illustrative Example of Applying the Approach in Question F.6.2

The purpose of this example is to illustrate the process of establishing, monitoring and adjusting hedge positions and of qualifying for cash flow hedge accounting in applying the approach to hedge accounting described in Question F.6.2 when an entity manages its interest rate risk on an entity-wide basis. To this end, this example identifies a methodology that allows for the use of hedge accounting and takes advantage of existing risk management systems so as to avoid unnecessary changes to it and to avoid unnecessary bookkeeping and tracking.

The approach illustrated here reflects only one of a number of risk management processes that could be employed and could qualify for hedge accounting. Its use is not intended to suggest that other alternatives could not or should not be used. The approach being illustrated could also be applied in other circumstances (such as for cash flow hedges), for example, hedging the rollover of commercial paper financing.

Identifying, Assessing and Reducing Cash Flow Exposures

The discussion and illustrations that follow focus on the risk management activities of an entity, such as a department of finance that manages its interest rate risk by analyzing expected cash flows in a particular currency on an entity-wide basis. The cash flow analysis forms the basis for identifying the interest rate risk of the entity, entering into hedging transactions to manage the risk, assessing the effectiveness of

risk management activities, and qualifying for and applying cash flow hedge accounting.

The illustrations that follow assume that an entity had the following expected future net cash flows and hedging positions outstanding in a specific currency, consisting of interest rate swaps, at the beginning of Period X0. The cash flows shown are expected to occur at the end of the period and, therefore, create a cash flow interest exposure in the following period as a result of the reinvestment or repricing of the cash inflows or the refinancing or repricing of the cash outflows.

The illustrations assume that the entity has an ongoing interest rate risk management program. Schedule I shows the expected cash flows and hedging positions that existed at the beginning of Period X0. It is included here to provide a starting point in the analysis. It provides a basis for considering existing hedges in connection with the evaluation that occurs at the beginning of Period X1.

Schedule I End of Period: Expected Cash Flows and Hedging Positions							
<i>Quarterly period (units)</i>	<i>X0 CU</i>	<i>X1 CU</i>	<i>X2 CU</i>	<i>X3 CU</i>	<i>X4 CU</i>	<i>X5 CU</i>	<i>n CU</i>
Expected net cash flows		1,100	1,500	1,200	1,400	1,500	x,xxx
<i>Outstanding interest rate swaps:</i>							
Receive-fixed, pay-variable (notional amounts)	2,000	2,000	2,000	1,200	1,200	1,200	x,xxx
Pay-fixed, receive-variable (notional amounts)	(1,000)	(1,000)	(1,000)	(500)	(500)	(500)	x,xxx
Net exposure after outstanding swaps		100	500	500	700	800	x,xxx

The schedule depicts five quarterly periods. The actual analysis would extend over a period of many years, represented by the notation "...n." An entity that manages its interest rate risk on an entity-wide basis re-evaluates its cash flow exposures periodically. The frequency of the evaluation depends on the entity's risk management policy.

For the purposes of this illustration, the entity is re-evaluating its cash flow exposures at the end of Period X0. The first step in the process is the generation of forecast net cash flow exposures from existing interest-earning assets and interest-bearing liabilities, including the rollover of short-term assets and short-term liabilities. Schedule II below illustrates the forecast of net cash flow exposures. A common technique for assessing exposure to interest rates for risk management purposes is an interest rate sensitivity gap analysis showing the gap between interest rate-sensitive assets and interest rate-sensitive liabilities over different time intervals.

Such an analysis could be used as a starting point for identifying cash flow exposures to interest rate risk for hedge accounting purposes.

Schedule II Forecast Net Cash Flow and Repricing Exposures							
<i>Quarterly period (units)</i>	<i>Notes</i>	<i>X1 CU</i>	<i>X2 CU</i>	<i>X3 CU</i>	<i>X4 CU</i>	<i>X5 CU</i>	<i>n CU</i>
CASH INFLOW AND REPRICING EXPOSURES – from assets							
<i>Principal and interest payments:</i>							
Long-term fixed rate	(1)	2,400	3,000	3,000	1,000	1,200	x,xxx
Short-term (roll over)	(1)(2)	1,575	1,579	1,582	1,586	1,591	x,xxx
Variable rate – principal payments	(1)	2,000	1,000	–	500	500	x,xxx
Variable rate – estimated interest	(2)	125	110	105	114	118	x,xxx
<i>Total expected cash inflows</i>		<i>6,100</i>	<i>5,689</i>	<i>4,687</i>	<i>3,200</i>	<i>3,409</i>	<i>x,xxx</i>
Variable rate asset balances	(3)	8,000	7,000	7,000	6,500	6,000	x,xxx
<i>Cash inflows and repricings</i>	(4)	<i>14,100</i>	<i>12,689</i>	<i>11,687</i>	<i>9,700</i>	<i>9,409</i>	<i>x,xxx</i>
CASH OUTFLOW AND REPRICING EXPOSURES - from liabilities							
<i>Principal and interest payments:</i>							
Long-term fixed rate	(1)	2,100	400	500	500	301	x,xxx
Short-term (roll over)	(1)(2)	735	737	738	740	742	x,xxx
Variable rate – principal payments	(1)	–	–	2,000	–	1,000	x,xxx
Variable rate – estimated interest	(2)	100	110	120	98	109	x,xxx
<i>Total expected cash outflows</i>		<i>2,935</i>	<i>1,247</i>	<i>3,358</i>	<i>1,338</i>	<i>2,152</i>	<i>x,xxx</i>
Variable rate liability balances	(3)	8,000	8,000	6,000	6,000	5,000	x,xxx
<i>Cash outflows and repricings</i>	(4)	<i>10,935</i>	<i>9,247</i>	<i>9,358</i>	<i>7,338</i>	<i>7,152</i>	<i>x,xxx</i>
<i>NET EXPOSURES</i>	(5)	<i>3,165</i>	<i>3,442</i>	<i>2,329</i>	<i>2,362</i>	<i>2,257</i>	<i>x,xxx</i>

Schedule II Forecast Net Cash Flow and Repricing Exposures

1. The cash flows are estimated using contractual terms and assumptions based on management's intentions and market factors. It is assumed that short-term assets and liabilities will continue to be rolled over in succeeding periods. Assumptions about prepayments and defaults and the withdrawal of deposits are based on market and historical data. It is assumed that principal and interest inflows and outflows will be reinvested and refinanced, respectively, at the end of each period at the then current market interest rates and share the benchmark interest rate risk to which they are exposed.
2. Forward interest rates obtained from Schedule VI are used to forecast interest payments on variable rate financial instruments and expected rollovers of short-term assets and liabilities. All forecast cash flows are associated with the specific time periods (3 months, 6 months, 9 months, and 12 months) in which they are expected to occur. For completeness, the interest cash flows resulting from reinvestments, refinancings and repricings are included in the schedule and shown gross even though only the net margin may actually be reinvested. Some entities may choose to disregard the forecast interest cash flows for risk management purposes because they may be used to absorb operating costs and any remaining amounts would not be significant enough to affect risk management decisions.
3. The cash flow forecast is adjusted to include the variable rate asset and liability balances in each period in which such variable rate asset and liability balances are repriced. The principal amounts of these assets and liabilities are not actually being paid and, therefore, do not generate a cash flow. However, since interest is computed on the principal amounts for each period based on the then current market interest rate, such principal amounts expose the entity to the same interest rate risk as if they were cash flows being reinvested or refinanced.
4. The forecast cash flow and repricing exposures that are identified in each period represent the principal amounts of cash inflows that will be reinvested or repriced and cash outflows that will be refinanced or repriced at the market interest rates that are in effect when those forecast transactions occur.
5. The net cash flow and repricing exposure is the difference between the cash inflow and repricing exposures from assets and the cash outflow and repricing exposures from liabilities. In the illustration, the entity is exposed to interest rate declines because the exposure from assets exceeds the exposure from liabilities and the excess (i.e., the net amount) will be reinvested or repriced at the current market rate and there is no offsetting refinancing or repricing of outflows.

Note that some entities may regard some portion of their non-interest bearing demand deposits as economically equivalent to long-term debt. However, these deposits do not create a cash flow exposure to interest rates and would therefore be excluded from this analysis for accounting purposes.

Schedule II Forecast net cash flow and repricing exposures provides no more than a starting point for assessing cash flow exposure to interest rates and for adjusting hedging positions. The complete analysis includes outstanding hedging positions and is shown in Schedule III Analysis of expected net exposures and hedging positions. It compares the forecast net cash flow exposures for each period (developed in Schedule II) with existing hedging positions (obtained from Schedule I), and

provides a basis for considering whether adjustment of the hedging relationship should be made.

Schedule III Analysis of Expected Net Exposures and Hedging Positions						
<i>Quarterly period (units)</i>	<i>X1 CU</i>	<i>X2 CU</i>	<i>X3 CU</i>	<i>X4 CU</i>	<i>X5 CU</i>	<i>...n CU</i>
Net cash flow and repricing exposures (Schedule II)	3,165	3,442	2,329	2,362	2,257	x,xxx
<i>Pre-existing swaps outstanding:</i>						
Receive-fixed, pay-variable (notional amounts)	2,000	2,000	1,200	1,200	1,200	x,xxx
Pay-fixed, receive-variable (notional amounts)	(1,000)	(1,000)	(500)	(500)	(500)	x,xxx
<i>Net exposure after pre-existing swaps</i>	<i>2,165</i>	<i>2,442</i>	<i>1,629</i>	<i>1,662</i>	<i>1,557</i>	<i>x,xxx</i>
<i>Transactions to adjust outstanding hedging positions:</i>						
Receive-fixed, pay variable swap 1 (notional amount, 10-years)	2,000	2,000	2,000	2,000	2,000	x,xxx
Pay-fixed, receive-variable swap 2 (notional amount, 3-years)			(1,000)	(1,000)	(1,000)	x,xxx
Swaps ...X						x,xxx
<i>Unhedged cash flow and repricing exposure</i>	<i>165</i>	<i>442</i>	<i>629</i>	<i>662</i>	<i>557</i>	<i>x,xxx</i>

The notional amounts of the interest rate swaps that are outstanding at the analysis date are included in each of the periods in which the interest rate swaps are outstanding to illustrate the impact of the outstanding interest rate swaps on the identified cash flow exposures. The notional amounts of the outstanding interest rate swaps are included in each period because interest is computed on the notional amounts each period, and the variable rate components of the outstanding swaps are repriced to the current market rate quarterly. The notional amounts create an exposure to interest rates that in part is similar to the principal balances of variable rate assets and variable rate liabilities.

The exposure that remains after considering the existing positions is then evaluated to determine the extent to which adjustments of existing hedging positions are necessary. The bottom portion of Schedule III shows the beginning of Period X1 using interest rate swap transactions to reduce the net exposures further to within the tolerance levels established under the entity's risk management policy.

Note that in the illustration, the cash flow exposure is not entirely eliminated. Many entities do not fully eliminate risk but rather reduce it to within some tolerable limit.

Various types of derivative instruments could be used to manage the cash flow exposure to interest rate risk identified in the schedule of forecast net cash flows (Schedule II). However, for the purpose of the illustration, it is assumed that interest rate swaps are used for all hedging activities. It is also assumed that in periods in

which interest rate swaps should be reduced, rather than terminating some of the outstanding interest rate swap positions, a new swap with the opposite return characteristics is added to the portfolio.

In the illustration in Schedule III above, swap 1, a receive-fixed, pay-variable swap, is used to reduce the net exposure in Periods X1 and X2. Since it is a 10-year swap, it also reduces exposures identified in other future periods not shown. However, it has the effect of creating an over-hedged position in Periods X3–X5. Swap 2, a forward starting pay-fixed, receive-variable interest rate swap, is used to reduce the notional amount of the outstanding receive-fixed, pay-variable interest rate swaps in Periods X3–X5 and thereby reduce the over-hedged positions.

It also is noted that in many situations, no adjustment or only a single adjustment of the outstanding hedging position is necessary to bring the exposure to within an acceptable limit. However, when the entity's risk management policy specifies a very low tolerance of risk a greater number of adjustments to the hedging positions over the forecast period would be needed to further reduce any remaining risk.

To the extent that some of the interest rate swaps fully offset other interest rate swaps that have been entered into for hedging purposes, it is not necessary to include them in a designated hedging relationship for hedge accounting purposes. These offsetting positions can be combined, de-designated as hedging instruments, if necessary, and reclassified for accounting purposes from the hedging portfolio to the trading portfolio. This procedure limits the extent to which the gross swaps must continue to be designated and tracked in a hedging relationship for accounting purposes. For the purposes of this illustration it is assumed that CU500 of the pay-fixed, receive-variable interest rate swaps fully offset CU500 of the receive-fixed, pay-variable interest rate swaps at the beginning of Period X1 and for Periods X1–X5, and are de-designated as hedging instruments and reclassified to the trading account.

After reflecting these offsetting positions, the remaining gross interest rate swap positions from Schedule III are shown in Schedule IV as follows.

Schedule IV Interest Rate Swaps Designated as Hedges						
<i>Quarterly period (units)</i>	<i>X1 CU</i>	<i>X2 CU</i>	<i>X3 CU</i>	<i>X4 CU</i>	<i>X5 CU</i>	<i>...n CU</i>
Receive-fixed, pay-variable (notional amounts)	3,500	3,500	2,700	2,700	2,700	x,xxx
Pay-fixed, receive-variable (notional amounts)	(500)	(500)	(1,000)	(1,000)	(1,000)	x,xxx
<i>Net outstanding swaps positions</i>	<i>3,000</i>	<i>3,000</i>	<i>1,700</i>	<i>1,700</i>	<i>1,700</i>	<i>x,xxx</i>

For the purposes of the illustrations, it is assumed that swap 2, entered into at the beginning of Period X1, only partially offsets another swap being accounted for as a hedge and therefore continues to be designated as a hedging instrument.

*Hedge Accounting Considerations*Illustrating the Designation of the Hedging Relationship

The discussion and illustrations thus far have focused primarily on economic and risk management considerations relating to the identification of risk in future periods and the adjustment of that risk using interest rate swaps. These activities form the basis for designating a hedging relationship for accounting purposes.

The examples in IPSAS 29 focus primarily on hedging relationships involving a single hedged item and a single hedging instrument, but there is little discussion and guidance on portfolio hedging relationships for cash flow hedges when risk is being managed centrally. In this illustration, the general principles are applied to hedging relationships involving a component of risk in a portfolio having multiple risks from multiple transactions or positions.

Although designation is necessary to achieve hedge accounting, the way in which the designation is described also affects the extent to which the hedging relationship is judged to be effective for accounting purposes and the extent to which the entity's existing system for managing risk will be required to be modified to track hedging activities for accounting purposes. Accordingly, an entity may wish to designate the hedging relationship in a manner that avoids unnecessary systems changes by taking advantage of the information already generated by the risk management system and avoids unnecessary bookkeeping and tracking. In designating hedging relationships, the entity may also consider the extent to which ineffectiveness is expected to be recognized for accounting purposes under alternative designations.

The designation of the hedging relationship needs to specify various matters. These are illustrated and discussed here from the perspective of the hedge of the interest rate risk associated with the cash inflows, but the guidance can also be applied to the hedge of the risk associated with the cash outflows. It is fairly obvious that only a portion of the gross exposures relating to the cash inflows is being hedged by the interest rate swaps. Schedule V The general hedging relationship illustrates the designation of the portion of the gross reinvestment risk exposures identified in Schedule II as being hedged by the interest rate swaps.

Schedule V The General Hedging Relationship						
<i>Quarterly period (units)</i>	<i>X1 CU</i>	<i>X2 CU</i>	<i>X3 CU</i>	<i>X4 CU</i>	<i>X5 CU</i>	<i>...n CU</i>
Cash inflow repricing exposure (Schedule II)	14,100	12,689	11,687	9,700	9,409	x,xxx
Receive-fixed, pay-variable swaps (Schedule IV)	3,500	3,500	2,700	2,700	2,700	x,xxx
<i>Hedged exposure percentage</i>	<i>24.8%</i>	<i>27.6%</i>	<i>23.1%</i>	<i>27.8%</i>	<i>28.7%</i>	<i>xx.x%</i>

The hedged exposure percentage is computed as the ratio of the notional amount of the receive-fixed, pay-variable swaps that are outstanding divided by the gross exposure. Note that in Schedule V there are sufficient levels of forecast

reinvestments in each period to offset more than the notional amount of the receive-fixed, pay-variable swaps and satisfy the accounting requirement that the forecast transaction is highly probable.

It is not as obvious, however, how the interest rate swaps are specifically related to the cash flow interest risks designated as being hedged and how the interest rate swaps are effective in reducing that risk. The more specific designation is illustrated in Schedule VI The specific hedging relationship below. It provides a meaningful way of depicting the more complicated narrative designation of the hedge by focusing on the hedging objective to eliminate the cash flow variability associated with future changes in interest rates and to obtain an interest rate equal to the fixed rate inherent in the term structure of interest rates that exists at the commencement of the hedge.

The expected interest from the reinvestment of the cash inflows and repricings of the assets is computed by multiplying the gross amounts exposed by the forward rate for the period. For example, the gross exposure for Period X2 of CU14,100 is multiplied by the forward rate for Periods X2–X5 of 5.50 percent, 6.00 percent, 6.50 percent and 7.25 percent, respectively, to compute the expected interest for those quarterly periods based on the current term structure of interest rates. The hedged expected interest is computed by multiplying the expected interest for the applicable three-month period by the hedged exposure percentage.

Schedule VI The Specific Hedging Relationship								
<i>Term structure of interest rates</i>								
<i>Quarterly period</i>			<i>X1</i>	<i>X2</i>	<i>X3</i>	<i>X4</i>	<i>X5</i>	<i>...n</i>
Spot rates			5.00%	5.25%	5.50%	5.75%	6.05%	x.xx%
Forward rates ^(a)			5.00%	5.50%	6.00%	6.50%	7.25%	x.xx%
<i>Cash flow exposures and expected interest amounts</i>								
Repricing period	Time to forecast transaction	Gross amounts exposed	CU	CU	CU	CU	CU	CU
2	3 months	14,100	→	194	212	229	256	
3	6 months	12,689			190	206	230	xxx
4	9 months	11,687				190	212	xxx
5	12 months	9,700					176	xxx
6	15 months	9,409						xxx
Hedged percentage (Schedule V) in the previous period				24.8%	27.6%	23.1%	27.8%	xx.x%
Hedged expected interest				48	52	44	49	xx
(a) The forward interest rates are computed from the spot interest rates and rounded for the purposes of the presentation. Computations that are based on the forward interest rates are made based on the actual computed forward rate and then rounded for the purposes of the presentation.								

It does not matter whether the gross amount exposed is reinvested in long-term fixed rate debt or variable rate debt, or in short-term debt that is rolled over in each subsequent period. The exposure to changes in the forward interest rate is the same. For example, if the CU14,100 is reinvested at a fixed rate at the beginning of Period X2 for six months, it will be reinvested at 5.75 percent. The expected interest is based on the forward interest rates for Period X2 of 5.50 percent and for Period X3 of 6.00 percent, equal to a blended rate of 5.75 percent $(1.055 \times 1.060)^{0.5}$, which is the Period X2 spot rate for the next six months.

However, only the expected interest from the reinvestment of the cash inflows or repricing of the gross amount for the first three-month period after the forecast transaction occurs is designated as being hedged. The expected interest being hedged is represented by the shaded cells. The exposure for the subsequent periods is not hedged. In the example, the portion of the interest rate exposure being hedged is the forward rate of 5.50 percent for Period X2. In order to assess hedge effectiveness and compute actual hedge ineffectiveness on an ongoing basis, the entity may use the information on hedged interest cash inflows in Schedule VI and compare it with updated estimates of expected interest cash inflows (e.g., in a table that looks like Schedule II). As long as expected interest cash inflows exceed hedged interest cash inflows, the entity may compare the cumulative change in the fair value of the hedged cash inflows with the cumulative change in the fair value of the hedging instrument to compute actual hedge effectiveness. If there are insufficient expected interest cash inflows, there will be ineffectiveness. It is measured by comparing the cumulative change in the fair value of the expected interest cash flows to the extent they are less than the hedged cash flows with the cumulative change in the fair value of the hedging instrument.

Describing the Designation of the Hedging Relationship

As mentioned previously, there are various matters that should be specified in the designation of the hedging relationship that complicate the description of the designation but are necessary to limit ineffectiveness to be recognized for accounting purposes and to avoid unnecessary systems changes and bookkeeping. The example that follows describes the designation more fully and identifies additional aspects of the designation not apparent from the previous illustrations.

Example Designation*Hedging Objective*

The hedging objective is to eliminate the risk of interest rate fluctuations over the hedging period, which is the life of the interest rate swap, and in effect obtain a fixed interest rate during this period that is equal to the fixed interest rate on the interest rate swap.

Type of Hedge

Cash flow hedge.

Hedging Instrument

The receive-fixed, pay-variable swaps are designated as the hedging instrument. They hedge the cash flow exposure to interest rate risk.

Repricing of the swap hedges a three-month portion of the interest cash inflows that results from:

The forecast reinvestment or repricing of the principal amounts shown in Schedule V.

Unrelated investments or repricings that occur after the repricing dates on the swap over its life and involve different borrowers or lenders.

The Hedged Item—General

The hedged item is a portion of the gross interest cash inflows that will result from the reinvestment or repricing of the cash flows identified in Schedule V and are expected to occur within the periods shown on such schedule. The portion of the interest cash inflow that is being hedged has three components:

The principal component giving rise to the interest cash inflow and the period in which it occurs;

The interest rate component; and

The time component or period covered by the hedge.

The Hedged Item—The Principal Component

The portion of the interest cash inflows being hedged is the amount that results from the first portion of the principal amounts being invested or repriced in each period:

That is equal to the sum of the notional amounts of the received-fixed, pay-variable interest rate swaps that are designated as hedging instruments and outstanding in the period of the reinvestment or repricing, and

That corresponds to the first principal amounts of cash flow exposures that are invested or repriced at or after the repricing dates of the interest rate swaps.

The Hedged Item—The Interest Rate Component

The portion of the interest rate change that is being hedged is the change in both of the following:

The credit component of the interest rate being paid on the principal amount invested or repriced that is equal to the credit risk inherent in the interest rate swap. It is that portion of the interest rate on the investment that is equal to the interest index of the interest rate swap, such as LIBOR; and

The yield curve component of the interest rate that is equal to the repricing period on the interest rate swap designated as the hedging instrument.

The Hedged Item—The Hedged Period

The period of the exposure to interest rate changes on the portion of the cash flow exposures being hedged is:

The period from the designation date to the repricing date of the interest rate swap that occurs within the quarterly period in which, but not before, the forecast transactions occur; and

Its effects for the period after the forecast transactions occur equal to the repricing interval of the interest rate swap.

It is important to recognize that the swaps are not hedging the cash flow risk for a single investment over its entire life. The swaps are designated as hedging the cash flow risk from different principal investments and repricings that are made in each repricing period of the swaps over their entire term. The swaps hedge only the interest accruals that occur in the first period following the reinvestment. They are hedging the cash flow impact resulting from a change in interest rates that occurs up to the repricing of the swap. The exposure to changes in rates for the period from the repricing of the swap to the date of the hedged reinvestment of cash inflows or repricing of variable rate assets is not hedged. When the swap is repriced, the interest rate on the swap is fixed until the next repricing date and the accrual of the net swap settlements is determined. Any changes in interest rates after that date that affect the amount of the interest cash inflow are no longer hedged for accounting purposes.

Designation Objectives

Systems Considerations

Many of the tracking and bookkeeping requirements are eliminated by designating each repricing of an interest rate swap as hedging the cash flow risk from forecast reinvestments of cash inflows and repricings of variable rate assets for only a portion of the lives of the related assets. Much tracking and bookkeeping would be necessary if the swaps were instead designated as hedging the cash flow risk from forecast principal investments and repricings of variable rate assets over the entire lives of these assets.

This type of designation avoids keeping track of gains and losses recognized in net assets/equity after the forecast transactions occur (IPSAS 29.108 and IPSAS 29.109) because the portion of the cash flow risk being hedged is that portion that will be recognized in surplus or deficit in the period immediately following the forecast transactions that corresponds with the periodic net cash settlements on the swap. If the hedge were to cover the entire life of the assets being acquired, it would be necessary to associate a specific interest rate swap with the asset being acquired. If a forecast transaction is the acquisition of a fixed rate instrument, the fair value of the swap that hedged that transaction would be recognized in surplus or deficit to adjust the interest revenue on the asset when the interest revenue is recognized. The swap would then have to be terminated or redesignated in another hedging relationship. If a forecast transaction is the acquisition of a variable rate asset, the swap would continue in the hedging relationship but it would have to be tracked back to the asset acquired so that any fair value amounts on the swap recognized in net assets/equity could be recognized in surplus or deficit upon the subsequent sale of the asset.

It also avoids the necessity of associating with variable rate assets any portion of the fair value of the swaps that is recognized in net assets/equity. Accordingly, there is no portion of the fair value of the swap that is recognized in net assets/equity that should be recognized in surplus or deficit when a forecast transaction occurs or upon the sale of a variable rate asset.

This type of designation also permits flexibility in deciding how to reinvest cash flows when they occur. Since the hedged risk relates only to a single period that corresponds with the repricing period of the interest rate swap designated as the hedging instrument, it is not necessary to determine at the designation date whether the cash flows will be reinvested in fixed rate or variable rate assets or to specify at the date of designation the life of the asset to be acquired.

Effectiveness Considerations

Ineffectiveness is greatly reduced by designating a specific portion of the cash flow exposure as being hedged.

- Ineffectiveness due to credit differences between the interest rate swap and hedged forecast cash flow is eliminated by designating the cash flow risk being hedged as the risk attributable to changes in the interest rates that correspond with the rates inherent in the swap, such as the AA rate curve. This type of designation prevents changes resulting from changes in credit spreads from being considered as ineffectiveness.
- Ineffectiveness due to duration differences between the interest rate swap and hedged forecast cash flow is eliminated by designating the interest rate risk being hedged as the risk relating to changes in the portion of the yield curve that corresponds with the period in which the variable rate leg of the interest rate swap is repriced.
- Ineffectiveness due to interest rate changes that occur between the repricing date of the interest rate swap and the date of the forecast transactions is eliminated by simply not hedging that period of time. The period from the repricing of the swap and the occurrence of the forecast transactions in the period immediately following the repricing of the swap is left unhedged. Therefore, the difference in dates does not result in ineffectiveness.

Accounting Considerations

The ability to qualify for hedge accounting using the methodology described here is founded on provisions in IPSAS 29 and on interpretations of its requirements. Some of those are described in the answer to Question F.6.2 Hedge Accounting Considerations when Interest Rate Risk is Managed on a Net Basis. Some additional and supporting provisions and interpretations are identified below.

Hedging a Portion of the Risk Exposure

The ability to identify and hedge only a portion of the cash flow risk exposure resulting from the reinvestment of cash flows or repricing of variable rate instruments is found in IPSAS 29.90 as interpreted in the answers to Questions F.6.2 Issue (k) and F.2.17 Partial Term Hedging.

Hedging Multiple Risks with a Single Instrument

The ability to designate a single interest rate swap as a hedge of the cash flow exposure to interest rates resulting from various reinvestments of cash inflows or repricings of variable rate assets that occur over the life of the swap is founded on IPSAS 29.85 as interpreted in the answer to Question F.1.12 Hedges of More Than One Type of Risk.

Hedging Similar Risks in a Portfolio

The ability to specify the forecast transaction being hedged as a portion of the cash flow exposure to interest rates for a portion of the duration of the investment that gives rise to the interest payment without specifying at the designation date the expected life of the instrument and whether it pays a fixed or variable rate is founded on the answer to Question F.6.2 Issue (I), which specifies that the items in the portfolio do not necessarily have to have the same overall exposure to risk, providing they share the same risk for which they are designated as being hedged.

Hedge Terminations

The ability to de-designate the forecast transaction (the cash flow exposure on an investment or repricing that will occur after the repricing date of the swap) as being hedged is provided for in IPSAS 29.112 dealing with hedge terminations. While a portion of the forecast transaction is no longer being hedged, the interest rate swap is not de-designated, and it continues to be a hedging instrument for the remaining transactions in the series that have not occurred. For example, assume that an interest rate swap having a remaining life of one year has been designated as hedging a series of three quarterly reinvestments of cash flows. The next forecast cash flow reinvestment occurs in three months. When the interest rate swap is repriced in three months at the then current variable rate, the fixed rate and the variable rate on the interest rate swap become known and no longer provide hedge protection for the next three months. If the next forecast transaction does not occur until three months and ten days, the ten-day period that remains after the repricing of the interest rate swap is not hedged.

F.6.4 **Hedge Accounting: Premium or Discount on Forward Exchange Contract**

A forward exchange contract is designated as a hedging instrument, for example, in a hedge of a net investment in a foreign operation. Is it permitted to amortize the discount or premium on the forward exchange contract to surplus or deficit over the term of the contract?

No. The premium or discount on a forward exchange contract may not be amortized to surplus or deficit under IPSAS 29. Derivatives are always measured at fair value in the statement of financial position. The gain or loss resulting from a change in the fair value of the forward exchange contract is always recognized in surplus or deficit unless the forward exchange contract is designated and effective as a hedging

instrument in a cash flow hedge or in a hedge of a net investment in a foreign operation, in which case the effective portion of the gain or loss is recognized in net assets/equity. In that case, the amounts recognized in net assets/equity are recognized in surplus or deficit when the hedged future cash flows occur or on the disposal of the net investment, as appropriate. Under IPSAS 29.84(b), the interest element (time value) of the fair value of a forward may be excluded from the designated hedge relationship. In that case, changes in the interest element portion of the fair value of the forward exchange contract are recognized in surplus or deficit.

F.6.5 IPSAS 29 and IPSAS 4 Fair Value Hedge of Asset Measured at Cost

If the future sale of a ship carried at historical cost is hedged against the exposure to currency risk by foreign currency borrowing, does IPSAS 29 require the ship to be remeasured for changes in the exchange rate even though the basis of measurement for the asset is historical cost?

No. In a fair value hedge, the hedged item is remeasured. However, a foreign currency borrowing cannot be classified as a fair value hedge of a ship since a ship does not contain any separately measurable foreign currency risk. If the hedge accounting conditions in IPSAS 29.98 are met, the foreign currency borrowing may be classified as a cash flow hedge of an anticipated sale in that foreign currency. In a cash flow hedge, the hedged item is not remeasured.

Section G: Other

G.1 Disclosure of Changes in Fair Value

IPSAS 29 requires financial assets classified as available-for-sale (AFS) and financial assets and financial liabilities at fair value through surplus or deficit to be remeasured to fair value. Unless a financial asset or a financial liability is designated as a cash flow hedging instrument, fair value changes for financial assets and financial liabilities at fair value through surplus or deficit are recognized in surplus or deficit, and fair value changes for AFS assets are recognized in net assets/equity. What disclosures are required regarding the amounts of the fair value changes during a reporting period?

IPSAS 30.23 requires items of revenue, expense and gains and losses to be disclosed. This disclosure requirement encompasses items of revenue, expense and gains and losses that arise on remeasurement to fair value. Therefore, an entity provides disclosures of fair value changes, distinguishing between changes that are recognized in surplus or deficit and changes that are recognized in net assets/equity. Further breakdown is provided of changes that relate to:

- (a) AFS assets, showing separately the amount of gain or loss recognized in net assets/equity during the period and the amount that was recognized in surplus or deficit for the period;

- (b) Financial assets or financial liabilities at fair value through surplus or deficit, showing separately those fair value changes on financial assets or financial liabilities (i) designated as such upon initial recognition and (ii) classified as held for trading in accordance with IPSAS 29; and
- (c) Hedging instruments.

IPSAS 30 neither requires nor prohibits disclosure of components of the change in fair value by the way items are classified for internal purposes. For example, an entity may choose to disclose separately the change in fair value of those derivatives that in accordance with IPSAS 29 it categorizes as held for trading, but the entity classifies as part of risk management activities outside the trading portfolio.

In addition, IPSAS 30.10 requires disclosure of the carrying amounts of financial assets or financial liabilities at fair value through surplus or deficit, showing separately: (i) those designated as such upon initial recognition and (ii) those held for trading in accordance with IPSAS 29.

G.2 IPSAS 29 and IPSAS 2 Hedge Accounting: Statements of Cash Flows

How should cash flows arising from hedging instruments be classified in statements of cash flows?

Cash flows arising from hedging instruments are classified as operating, investing or financing activities, on the basis of the classification of the cash flows arising from the hedged item. While the terminology in IPSAS 2 has not been updated to reflect IPSAS 29, the classification of cash flows arising from hedging instruments in the statement of cash flows should be consistent with the classification of these instruments as hedging instruments under IPSAS 29.

Illustrative Examples

These examples accompany, but are not part of, IPSAS 29.

Hedging Interest Rate Risk for a Portfolio of Assets and Liabilities

- IE1. On January 1, 20X1 Entity A identifies a portfolio comprising assets and liabilities whose interest rate risk it wishes to hedge. The liabilities include demandable deposit liabilities that the depositor may withdraw at any time without notice. For risk management purposes, the entity views all of the items in the portfolio as fixed rate items.
- IE2. For risk management purposes, Entity A analyzes the assets and liabilities in the portfolio into repricing time periods based on expected repricing dates. The entity uses monthly time periods and schedules items for the next five years (i.e., it has 60 separate monthly time periods).³ The assets in the portfolio are prepayable assets that Entity A allocates into time periods based on the expected prepayment dates, by allocating a percentage of all of the assets, rather than individual items, into each time period. The portfolio also includes demandable liabilities that the entity expects, on a portfolio basis, to repay between one month and five years and, for risk management purposes, are scheduled into time periods on this basis. On the basis of this analysis, Entity A decides what amount it wishes to hedge in each time period.
- IE3. This example deals only with the repricing time period expiring in three months' time, i.e., the time period maturing on March 31, 20X1 (a similar procedure would be applied for each of the other 59 time periods). Entity A has scheduled assets of CU100 million and liabilities of CU80 million into this time period. All of the liabilities are repayable on demand.
- IE4. Entity A decides, for risk management purposes, to hedge the net position of CU20 million and accordingly enters into an interest rate swap⁴ on January 1, 20X1, 1 to pay a fixed rate and receive London Interbank Offered Rate (LIBOR), with a notional principal amount of CU20 million and a fixed life of three months.
- IE5. This example makes the following simplifying assumptions:
- (a) The coupon on the fixed leg of the swap is equal to the fixed coupon on the asset;

³ In this example principal cash flows have been scheduled into time periods but the related interest cash flows have been included when calculating the change in fair value of the hedged item. Other methods of scheduling assets and liabilities are also possible. Also, in this example, monthly repricing time periods have been used. An entity may choose narrower or wider time periods.

⁴ This example uses a swap as the hedging instrument. An entity may use forward rate agreements or other derivatives as hedging instruments.

- (b) The coupon on the fixed leg of the swap becomes payable on the same dates as the interest payments on the asset; and
- (c) The interest on the variable leg of the swap is the overnight LIBOR rate. As a result, the entire fair value change of the swap arises from the fixed leg only, because the variable leg is not exposed to changes in fair value due to changes in interest rates.

In cases when these simplifying assumptions do not hold, greater ineffectiveness will arise. (The ineffectiveness arising from (a) could be eliminated by designating as the hedged item a portion of the cash flows on the asset that are equivalent to the fixed leg of the swap).

IE6. It is also assumed that Entity A tests effectiveness on a monthly basis.

IE7. The fair value of an equivalent non-prepayable asset of CU20 million, ignoring changes in value that are not attributable to interest rate movements, at various times during the period of the hedge is as follows:

	Jan 1, 20X1	Jan 31, 20X1	Feb 1, 20X1	Feb 28, 20X1	Mar 31, 20X1
Fair value (asset) (CU)	20,000,000	20,047,408	20,047,408	20,023,795	Nil

IE8. The fair value of the swap at various times during the period of the hedge is as follows:

	Jan 1, 20X1	Jan 31, 20X1	Feb 1, 20X1	Feb-28, 20X1	Mar 31, 20X1
Fair value (liability) (CU)	Nil	(47,408)	(47,408)	(23,795)	Nil

Accounting Treatment

- IE9. On January 1, 20X1, Entity A designates as the hedged item an amount of CU20 million of assets in the three-month time period. It designates as the hedged risk the change in the value of the hedged item (i.e., the CU20 million of assets) that is attributable to changes in LIBOR. It also complies with the other designation requirements set out in paragraphs 98(d) and AG162 of the Standard.
- IE10. Entity A designates as the hedging instrument the interest rate swap described in paragraph IE4.

End of Month 1 (January 31, 20X1)

- IE11. On January 31, 20X1 (at the end of month 1) when Entity A tests effectiveness, LIBOR has decreased. Based on historical prepayment experience, Entity A estimates that, as a consequence, prepayments will occur faster than previously estimated. As a result it re-estimates the amount of assets scheduled into this time period (excluding new assets originated during the month) as CU96 million.

- IE12. The fair value of the designated interest rate swap with a notional principal of CU20 million is (CU47,408)⁵ (the swap is a liability).
- IE13. Entity A computes the change in the fair value of the hedged item, taking into account the change in estimated prepayments, as follows.
- First, it calculates the percentage of the initial estimate of the assets in the time period that was hedged. This is 20 percent (CU20 million ÷ CU100 million).
 - Second, it applies this percentage (20 percent) to its revised estimate of the amount in that time period (CU96 million) to calculate the amount that is the hedged item based on its revised estimate. This is CU19.2 million.
 - Third, it calculates the change in the fair value of this revised estimate of the hedged item (CU19.2 million) that is attributable to changes in LIBOR. This is CU45,511 (CU47,408⁶ × (CU19.2 million ÷ CU20 million)).
- IE14. Entity A makes the following accounting entries relating to this time period:
- | | | | |
|----|------|--|-----------|
| Dr | Cash | CU172,097 | |
| | Cr | Surplus or deficit (interest revenue) ⁷ | CU172,097 |
- To recognize the interest received on the hedged amount (CU19.2 million).*
- | | | | |
|----|---------------------------------------|---------------------------------------|-----------|
| Dr | Surplus or deficit (interest expense) | CU179,268 | |
| | Cr | Surplus or deficit (interest revenue) | CU179,268 |
| | Cr | Cash | Nil |
- To recognize the interest received and paid on the swap designated as the hedging instrument.*
- | | | | |
|----|---------------------------|----------------------|----------|
| Dr | Surplus or deficit (loss) | CU47,408 | |
| | Cr | Derivative liability | CU47,408 |
- To recognize the change in the fair value of the swap.*
- | | | | |
|----|---|---------------------------|----------|
| Dr | Separate line item in the statement of financial position | CU45,511 | |
| | Cr | Surplus or deficit (gain) | CU45,511 |
- To recognize the change in the fair value of the hedged amount.*
- IE15. The net result on surplus or deficit (excluding interest revenue and interest expense) is to recognize a loss of (CU1,897). This represents ineffectiveness in the hedging relationship that arises from the change in estimated prepayment dates.

⁵ See paragraph IE8.

⁶ i.e., CU20,047,408 – CU 20,000,000, see paragraph IE7.

⁷ This example does not show how amounts of interest revenue and interest expense are calculated.

Beginning of Month 2

- IE16. On February 1, 20X1 Entity A sells a proportion of the assets in the various time periods. Entity A calculates that it has sold 81/3 percent of the entire portfolio of assets. Because the assets were allocated into time periods by allocating a percentage of the assets (rather than individual assets) into each time period, Entity A determines that it cannot ascertain into which specific time periods the sold assets were scheduled. Hence it uses a systematic and rational basis of allocation. Based on the fact that it sold a representative selection of the assets in the portfolio, Entity A allocates the sale proportionately over all time periods.
- IE17. On this basis, Entity A computes that it has sold 81/3 percent of the assets allocated to the three-month time period, i.e., CU8 million (81/3 percent of CU96 million). The proceeds received are CU8,018,400, equal to the fair value of the assets.⁸ On derecognition of the assets, Entity A also removes from the separate line item in the statement of financial position an amount that represents the change in the fair value of the hedged assets that it has now sold. This is 81/3 percent of the total line item balance of CU45,511, i.e., CU3,793.
- IE18. Entity A makes the following accounting entries to recognize the sale of the asset and the removal of part of the balance in the separate line item in the statement of financial position:

Dr	Cash	CU8,018,400	
	Cr Asset		CU8,000,000
	Cr Separate line item in the statement of financial position		CU3,793
	Cr Surplus or deficit (gain)		CU14,607

To recognize the sale of the asset at fair value and to recognize a gain on sale

Because the change in the amount of the assets is not attributable to a change in the hedged interest rate, no ineffectiveness arises.

- IE19. Entity A now has CU88 million of assets and CU80 million of liabilities in this time period. Hence the net amount Entity A wants to hedge is now CU8 million and, accordingly, it designates CU8 million as the hedged amount.
- IE20. Entity A decides to adjust the hedging instrument by designating only a proportion of the original swap as the hedging instrument. Accordingly, it designates as the hedging instrument CU8 million or 40 percent of the notional amount of the original swap with a remaining life of two months and a fair value of CU18,963.⁹ It also complies with the other designation

⁸ The amount realized on sale of the asset is the fair value of a prepayable asset, which is less than the fair value of the equivalent non-prepayable asset shown in IE7.

⁹ CU47,408 × 40 percent.

requirements in paragraphs 98(a) and AG162 of the Standard. The CU12 million of the notional amount of the swap that is no longer designated as the hedging instrument is either classified as held for trading with changes in fair value recognized in surplus or deficit, or is designated as the hedging instrument in a different hedge.¹⁰

- IE21. As at February 1, 20X1 and after accounting for the sale of assets, the separate line item in the statement of financial position is CU41,718 (CU45,511 – CU3,793), which represents the cumulative change in fair value of CU17.6¹¹ million of assets. However, as at February 1, 20X1, Entity A is hedging only CU8 million of assets that have a cumulative change in fair value of CU18,963.¹² The remaining separate line item in the statement of financial position of CU22,755¹³ relates to an amount of assets that Entity A still holds but is no longer hedging. Accordingly Entity A amortizes this amount over the remaining life of the time period, i.e., it amortizes CU22,755 over two months.
- IE22. Entity A determines that it is not practicable to use a method of amortization based on a recalculated effective yield and hence uses a straight-line method.

End of Month 2 (February 28, 20X1)

- IE23. On February 28, 20X1 when Entity A next tests effectiveness, LIBOR is unchanged. Entity A does not revise its prepayment expectations. The fair value of the designated interest rate swap with a notional principal of CU8 million is (CU9,518)¹⁴ (the swap is a liability). Also, Entity A calculates the fair value of the CU8 million of the hedged assets as at February 28, 20X1 as CU8,009,518.¹⁵
- IE24. Entity A makes the following accounting entries relating to the hedge in this time period:

Dr	Cash	CU71,707	
	Cr	Surplus or deficit (interest revenue)	CU71,707

To recognize the interest received on the hedged amount (CU8 million).

Dr	Surplus or deficit (interest expense)	CU71,707
----	---------------------------------------	----------

¹⁰ The entity could instead enter into an offsetting swap with a notional principle of CU12 million to adjust its position and designate as the hedging instrument all CU20 million of the existing swap and all CU12 million of the new offsetting swap.

¹¹ CU19.2 million – (8⅓ × CU19.2 million).

¹² CU41,718 × (CU8 million/CU17.6 million).

¹³ CU41,718 – CU18,963.

¹⁴ CU23,795 [see paragraph IE8] × (CU8 million/CU20 million).

¹⁵ CU20,023,795 [see paragraph IE7] × (CU8 million/CU20 million).

Cr	Surplus or deficit(interest revenue)	CU62,115
Cr	Cash	CU9,592

To recognize the interest received and paid on the portion of the swap designated as the hedging instrument (CU8 million).

Dr	Derivative liability	CU9,445
Cr	Surplus or deficit (gain)	CU9,445

To recognize the change in the fair value of the portion of the swap designated as the hedging instrument (CU8 million) (CU9,518 – CU18,963).

Dr	Surplus or deficit (loss)	CU9,445
Cr	Separate line item in the statement of financial position	CU9,445

To recognize the change in the fair value of the hedged amount (CU8,009,518 – CU8,018,963).

- IE25. The net effect on surplus or deficit (excluding interest revenue and interest expense) is nil reflecting that the hedge is fully effective.
- IE26. Entity A makes the following accounting entry to amortize the line item balance for this time period:

Dr	Surplus or deficit (loss)	CU11,378
Cr	Separate line item in the statement of financial position	CU11,378 (a)

To recognize the amortization charge for the period.

(a) $CU22,755 \div 2$

End of Month 3

- IE27. During the third month there is no further change in the amount of assets or liabilities in the three-month time period. On March 31, 20X1 the assets and the swap mature and all balances are recognized in surplus or deficit.
- IE28. Entity A makes the following accounting entries relating to this time period:

Dr	Cash	CU8,071,707
Cr	Asset (statement of financial position)	CU8,000,000
Cr	Surplus or deficit (interest revenue)	CU71,707

To recognize the interest and cash received on maturity of the hedged amount (CU8 million).

Dr	Surplus or deficit (interest expense)	CU71,707
Cr	Surplus or deficit (interest-revenue)	CU62,115
Cr	Cash	CU9,592

To recognize the interest received and paid on the portion of the swap designated as the hedging instrument (CU8 million).

Dr	Derivative liability	CU9,518	
	Cr	Surplus or deficit (gain)	CU9,518

To recognize the expiry of the portion of the swap designated as the hedging instrument (CU8 million).

Dr	Surplus or deficit (gain)	CU9,518	
	Cr	Separate line item in the statement of financial position	CU9,518

To remove the remaining line item balance on expiry of the time period.

IE29. The net effect on surplus or deficit (excluding interest revenue and interest expense) is nil reflecting that the hedge is fully effective.

IE30. Entity A makes the following accounting entry to amortize the line item balance for this time period:

Dr	Surplus or deficit (loss)	CU11,377	
	Cr		CU11,377 ^(a)

To recognize the amortization charge for the period.

(a) $CU22,755 \div 2$

Summary

IE31. The tables below summarize:

- (a) Changes in the separate line item in the statement of financial position;
- (b) The fair value of the derivative;
- (c) The surplus or deficit effect of the hedge for the entire three-month period of the hedge; and
- (d) Interest revenue and interest expense relating to the amount designated as hedged.

Description	Jan 1, 20X1 CU	Jan 31, 20X1 CU	Feb 1, 20X1 CU	Feb 28, 20X1 CU	Mar 31, 20X1 CU
Amount of asset hedged	20,000,000	19,200,000	8,000,000	8,000,000	8,000,000

(a) Changes in the separate line item in the statement of financial position

Brought forward:

Balance to be amortized	Nil	Nil	Nil	22,755	11,377
Remaining balance	Nil	Nil	45,511	18,963	9,518
Less: Adjustment on sale of asset	Nil	Nil	(3,793)	Nil	Nil
Adjustment for change in fair value of the hedged asset	Nil	45,511	Nil	(9,445)	(9,518)
Amortization	Nil	Nil	Nil	(11,378)	(11,377)

Carried forward:

Balance to be amortized	Nil	Nil	22,755	11,377	Nil
Remaining balance	Nil	45,511	18,963	9,518	Nil

(b) The fair value of the derivative

CU20,000,000	Nil	47,408	—	—	—
CU12,000,000	Nil	—	28,445	No longer designated as the hedging instrument.	
CU8,000,000	Nil	—	18,963	9,518	Nil
Total	Nil	47,408	47,408	9,518	Nil

(c) Effect of the hedge on surplus or deficit

Change in line item: asset	Nil	45,511	N/A	(9,445)	(9,518)
Change in derivative fair value	Nil	(47,408)	N/A	9,445	9,518
Net effect	Nil	(1,897)	N/A	Nil	Nil
Amortization	Nil	Nil	N/A	(11,378)	(11,377)

In addition, there is a gain on sale of assets of CU14,607 at February 1, 20X1.

(d) Interest revenue and interest expense relating to the amount designated as hedged

Interest revenue

— on the asset	Nil	172,097	N/A	71,707	71,707
— on the swap	Nil	179,268	N/A	62,115	62,115

Interest expense

— on the swap	Nil	(179,268)	N/A	(71,707)	(71,707)
---------------	-----	-----------	-----	----------	----------

Disposal of a Foreign Operation

- IE32. This example illustrates the application of paragraphs C12 and C13 of Appendix C in connection with the amount recognized in surplus or deficit on the disposal of a foreign operation.

Background

- IE33. This example assumes the economic entity structure set out in the application guidance and that Entity D used a USD borrowing in Entity A to hedge the EUR/USD risk of the net investment in Entity C in Entity D's consolidated financial statements. Entity D uses the step-by-step method of consolidation. Assume the hedge was fully effective and the full USD/EUR accumulated change in the value of the hedging instrument before disposal of Entity C is €24 million (gain). This is matched exactly by the fall in value of the net investment in Entity C, when measured against the functional currency of Entity D (euro).
- IE34. If the direct method of consolidation is used, the fall in the value of Entity D's net investment in Entity C of €24 million would be reflected totally in the foreign currency translation reserve relating to Entity C in Entity D's consolidated financial statements. However, because Entity D uses the step-by-step method, this fall in the net investment value in Entity C of €24 million would be reflected both in Entity B's foreign currency translation reserve relating to Entity C and in Entity D's foreign currency translation reserve relating to Entity B.
- IE35. The aggregate amount recognized in the foreign currency translation reserve in respect of Entities B and C is not affected by the consolidation method. Assume that using the direct method of consolidation, the foreign currency translation reserves for Entities B and C in Entity D's consolidated financial statements are €62 million gain and €24 million loss respectively; using the step-by-step method of consolidation those amounts are €49 million gain and €11 million loss respectively.

Reclassification

- IE36. When the investment in Entity C is disposed of, IPSAS 29 requires the full €24 million gain on the hedging instrument to be recognized in surplus or deficit. Using the step-by-step method, the amount to be recognized in surplus or deficit in respect of the net investment in Entity C would be only €11 million loss. Entity D could adjust the foreign currency translation reserves of both Entities B and C by €13 million in order to match the amounts reclassified in respect of the hedging instrument and the net investment as would have been the case if the direct method of consolidation had been used, if that was its accounting policy. An entity that had not hedged its net investment could make the same reclassification.

Receipt of a Concessionary Loan

- IE37. A local authority receives loan funding to the value of CU5 million from an international development agency to build primary healthcare clinics over a period of 5 years. The agreement stipulates that loan should be repaid over the 5 year period as follows:

Year 1: no capital repayments

Year 2: 10% of the capital

Year 3: 20% of the capital

Year 4: 30% of the capital

Year 5: 40% of the capital

Interest is paid annually in arrears, at a rate of 5% per annum on the outstanding balance of the loan. A market related rate of interest for a similar transaction is 10%.

- IE38. The entity has received a concessionary loan of CU5 million, which will be repaid at 5% below the current market interest rate. The difference between the proceeds of the loan and the present value of the contractual payments in terms of the loan agreement, discounted using the market related rate of interest, is recognized as non-exchange revenue.

- IE39. The journal entries to account for the concessionary loan are as follows:

- On initial recognition, the entity recognizes the following (assuming that the entity subsequently measures concessionary loan at amortized cost):

Dr	Bank	5,000,000	
	Cr	Loan (refer to Table 2 below)	4,215,450
	Cr	Liability or non-exchange revenue	784,550

Recognition of the receipt of the loan at fair value

IPSAS 23 is considered in recognizing either a liability or revenue for the off-market portion of the loan. Example 26 of that Standard provides journal entries for the recognition and measurement of the off-market portion of the loan deemed to be non-exchange revenue.

- Year 1: The entity recognizes the following:

Dr	Interest (refer to Table 3 below)	421,545	
	Cr	Loan	421,545

Recognition of interest using the effective interest method (CU4,215,450 × 10%)

Dr	Loan (refer to Table 1 below)	250,000	
	Cr	Bank	250,000

Recognition of interest paid on outstanding balance (CU5m × 5%)

FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

3. Year 2: The entity recognizes the following:

Dr	Interest	438,700	
	Cr Loan		438,700

Recognition of interest using the effective interest method (CU4,386,995 × 10%)

Dr	Loan	750,000	
	Cr Bank		750,000

Recognition of interest paid on outstanding balance (CU5m × 5% + CU500,000 capital repaid)

4. Year 3: The entity recognizes the following:

Dr	Interest	407,569	
	Cr Loan		407,569

Recognition of interest using the effective interest method (CU4,075,695 × 10%)

Dr	Loan	1,225,000	
	Cr Bank		1,225,000

Recognition of interest paid on outstanding balance (CU4.5m × 5% + CU1m capital repaid)

5. Year 4: The entity recognizes the following:

Dr	Interest	325,826	
	Cr Loan		325,826

Recognition of interest using the effective interest method (CU 3,258,264 × 10%)

Dr	Loan	1,675,000	
	Cr Bank		1,675,000

Recognition of interest paid on outstanding balance (CU3.5m × 5% + CU1.5m capital repaid)

6. Year 5: The entity recognizes the following:

Dr	Interest	190,909	
	Cr Loan		190,909

Recognition of interest using the effective interest method (CU1,909,091 × 10%)

Dr	Loan	2,100,000	
	Cr Bank		2,100,000

Recognition of interest paid on outstanding balance (CU2m × 5% + CU2m capital repaid)

*Calculations:***Table 1: Amortization Schedule (Using Contractual Repayments at 5% Interest)**

	Year 0 CU	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU
Capital	5,000,000	5,000,000	5,000,000	4,500,000	3,500,000	2,000,000
Interest	–	250,000	250,000	225,000	175,000	100,000
Payments	–	(250,000)	(750,000)	(1,225,000)	(1,675,000)	(2,100,000)
Balance	5,000,000	5,000,000	4,500,000	3,500,000	2,000,000	–

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 10%)

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU
Capital balance	5,000,000	4,500,000	3,500,000	2,000,000	–
Interest payable	250,000	250,000	225,000	175,000	100,000
Total payments (capital and interest)	250,000	750,000	1,225,000	1,675,000	2,100,000
Present value of payments	227,272	619,835	920,360	1,144,048	1,303,935
Total present value of payments					<u>4,215,450</u>
Proceeds received					5,000,000
Less: Present value of outflows (fair value of loan on initial recognition)					<u>4,215,450</u>
Off-market portion of loan to be recognized as non-exchange revenue					<u>784,550</u>

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU
Capital	4,215,450	4,386,995	4,075,695	3,258,264	1,909,091
Interest accrual	421,545	438,700	407,569	325,827	190,909
Interest and capital payments	250,000	750,000	1,225,000	1,675,000	2,100,000
Balance	4,386,995	4,075,695	3,258,264	1,909,091	–

Payment of a Concessional Loan

IE40. The department of education makes low interest loans available to qualifying students on flexible repayment terms as a means of promoting university education.

IE41. The department advanced CU250 million to various students at the beginning of the financial year, with the following terms and conditions:

- Capital is repaid as follows:
 - Year 1 to 3: no capital repayments
 - Year 4: 30% capital to be repaid
 - Year 5: 30% capital to be repaid
 - Year 6: 40% capital to be repaid
- Interest is calculated at 6% interest on the outstanding loan balance, and is paid annually in arrears. Assume the market rate of interest for a similar loan is 11.5%.

IE42. The journal entries to account for the concessionary loan are as follows (assuming the entity subsequently measures the concessionary loan at amortized cost):

1. On initial recognition, the entity recognizes the following:

Dr	Loan	199,345,480	
Dr	Expense	50,654,520	
Cr	Bank		250,000,000

2. Year 1: The entity recognizes the following

Dr	Loan	22,924,730	
Cr	Interest revenue		22,924,730

Interest accrual using the effective interest method $CU199,345,480 \times 11.5\%$

Dr	Bank	15,000,000	
Cr	Loan		15,000,000

Interest payment of $CU250m \times 6\%$

3. Year 2: The entity recognizes the following:

Dr	Loan	23,836,074	
Cr	Interest revenue		23,836,074

Interest accrual using the effective interest method $CU207,270,210 \times 11.5\%$

Dr	Bank	15,000,000	
Cr	Loan		15,000,000

Interest payment of $CU250m \times 6\%$

4. Year 3: The entity recognizes the following:

Dr	Loan	24,852,223	
	Cr	Interest revenue	24,852,223

Interest accrual using the effective interest method $CU216,106,284 \times 11.5\%$

Dr	Bank	15,000,000	
	Cr	Loan	15,000,000

5. Year 4: The entity recognizes the following:

Dr	Loan	25,985,228	
	Cr	Interest revenue	25,985,228

Interest accrual using the effective interest method $CU225,958,228 \times 11.5\%$

Dr	Bank	90,000,000	
	Cr	Loan	90,000,000

Interest payment of $CU250m \times 6\% + CU75m$ capital repaid

6. Year 5: The entity recognizes the following:

Dr	Loan	18,623,530	
	Cr	Interest revenue	18,623,530

Interest accrual using the effective interest method $CU161,943,735 \times 11.5\%$

Dr	Bank	85,500,000	
	Cr	Loan	85,500,000

Interest payment of $CU175m \times 6\% + CU75m$ capital repaid

7. Year 6: The entity recognizes the following:

Dr	Loan	10,932,735	
	Cr	Interest revenue	10,932,735

Interest accrual using the effective interest method $CU95,067,265 \times 11.5\%$

Dr	Bank	106,000,000	
	Cr	Loan	106,000,000

Recognition of capital repaid

*Calculations***Table 1: Amortization Schedule (Using Contractual Repayments at 6% Interest)**

	Year 0 CU'000	Year 1 CU'000	Year 2 CU'000	Year 3 CU'000	Year 4 CU'000	Year 5 CU'000	Year 6 CU'000
Capital	250,000	250,000	250,000	250,000	250,000	250,000	250,000
Interest	–	15,000	15,000	15,000	15,000	10,500	6,000
Payments	–	15,000	15,000	15,000	90,000	85,500	106,000
Balance	250,000	250,000	250,000	250,000	175,000	100,000	–

Table 2: Discounting Contractual Cash Flows (Based on a Market Rate of 11.5%)

	Year 1 CU'000	Year 2 CU'000	Year 3 CU'000	Year 4 CU'000	Year 5 CU'000	Year 6 CU'000
Capital balance	250,000	250,000	250,000	175,000	100,000	–
Interest payable	15,000	15,000	15,000	15,000	10,500	6,000
Total payments (capital and interest)	15,000	15,000	15,000	90,000	85,500	106,000
Present value of payments	13,452,915	12,065,394	10,820,981	58,229,497	49,612,576	55,164,117
Total present value of payments						199,345,480
Proceeds paid						250,000,000
Less: Present value of outflows (fair value of loan on initial recognition)						50,654,520
Off-market portion of loan to be recognized as expense						199,345,480

Table 3: Calculation of Loan Balance and Interest Using the Effective Interest Method

	Year 1 CU	Year 2 CU	Year 3 CU	Year 4 CU	Year 5 CU	Year 6 CU
Capital	199,345,480	207,270,210	216,106,284	225,958,228	161,943,735	95,067,265
Interest accrual	22,924,730	23,836,074	24,852,223	25,985,228	18,623,530	10,932,735
Interest and capital payments	15,000,000	15,000,000	15,000,000	90,000,000	85,500,000	106,000,000
Balance	207,270,210	216,106,284	225,958,228	161,943,735	95,067,265	–

Financial Guarantee Contract Provided at Nominal Consideration

- IE43. Entity C is a major motor vehicle manufacturer in Jurisdiction A. On January 1, 201V Government A (the issuer) enters into a financial guarantee contract with Entity B (the holder) to reimburse Entity B against the financial effects of default by Entity C (the debtor) for a 30 year loan of 50 million Currency Units (CUs) repayable in two equal instalments of 25 million CUs in 201X and 204Z. Entity C provides nominal consideration of 30,000 CUs to Government A. Prior to entering into negotiation with Government A, Entity C had approached a number of other entities to issue a guarantee, but none of these entities was prepared to issue such a guarantee. There are no recent examples of financial guarantee contracts in the motor manufacturing sector of the economy in Jurisdiction A or in neighbouring Jurisdictions D & E. Government A concludes that it cannot use a valuation technique as the use of a valuation technique does not provide a reliable measure of fair value. Government A therefore determines to measure the financial guarantee contract in accordance with IPSAS 19.
- IE44. On December, 31 201V, having reviewed the financial position and performance of Entity C, Government A determines that there is no present obligation to Entity B in respect of the financial guarantee contract. Government A does not recognize a liability in its statement of financial position. Government A makes the disclosures relating to fair value and credit risk in IPSAS 30, *Financial Instruments: Disclosures* in respect of the financial guarantee contract. It also discloses a contingent liability of 50 million CUs in accordance with IPSAS 19. In its statement of financial performance Government A recognizes revenue of 1,000 CUs in respect of the nominal consideration payable by Entity C.
- IE45. In 201Z there has been a further downturn in the motor manufacturing sector affecting Entity C. Entity C is seeking bankruptcy protection and has defaulted on the first repayment of principal, although it has met its obligations for interest payments. Government A determines that Entity C is unlikely to recover, but negotiations are advanced with a potential acquirer (Entity D), which will restructure Entity C. Entity D has indicated that it will assume responsibility for the final instalment of the loan with Entity B, but not the initial instalment. Government A recognizes an expense and liability for 25 million CUs and discloses a contingent liability of 25 million CUs.

Interaction Between Measurement Requirements of IPSAS 23 and IPSAS 29*Background*

- IE46. An individual donates shares in listed entity X to public sector entity A on January 1, 20X8. At that date, the shares in entity X have a fair value of

CU1,000,000. At December 31, 20X8, the fair value of the shares is CU900,000. As part of the arrangement, entity A incurs the transfer duty to have the shares transferred into its name. These costs amount to CU10,000.

- IE47. Listed entity X provides telecommunications infrastructure and related services to the public. During 20X9, new technology was introduced into the telecommunications industry, making the infrastructure and equipment used by entity X almost obsolete. This resulted in a permanent decline in the value of listed entity X. The value of the impairment loss as at December 31, 20X9 is CU700,000. Entity A has a policy of accounting for investments in shares as an available-for-sale financial asset. Assume that the arrangement is a contractual arrangement, no present obligations arise from the donation and that the entity's reporting period ends on December 31, 20X8.

Analysis

- IE48. As entity A received the shares as a donation, it uses IPSAS 23 to initially recognize the shares acquired and the related non-exchange revenue. However, because entity A has acquired a financial asset, it considers the initial measurement requirements of IPSAS 23 and IPSAS 29.
- IE49. IPSAS 23 prescribes that assets acquired as part of a non-exchange revenue transaction are initially measured at fair value, while IPSAS 29 prescribes that financial assets are initially measured at fair value and, depending on their classification, transaction costs may or may not be included. As the entity has a policy of accounting for investments in shares as available-for-sale financial assets, the transaction costs of CU10,000 are added to the value of the shares of CU1,000,000 on initial measurement.
- IE50. The subsequent measurement and derecognition of the shares is addressed in IPSAS 29. The entity classifies investments in shares as available-for-sale financial assets which means that the shares are measured at a fair value with any subsequent changes in fair value recognized in net assets/equity. Impairment losses are however recognized in surplus or deficit in the period in which they occur.

The journal entries at initial acquisition and at the reporting dates are as follows:

1. Acquisition of shares through donation

Dr	Available-for-sale financial asset (investment in entity X)	1,010,000
	Cr Non-exchange revenue	1,000,000
	Cr Bank (Transfer costs paid)	10,000
2. Subsequent measurement at December 31, 20X8

Dr	Net assets/equity (fair value adjustment)	110,000
----	---	---------

FINANCIAL INSTRUMENTS: RECOGNITION AND MEASUREMENT

	of investment)		
	Cr	Available-for-sale financial asset (investment in entity X)	110,000
3.	Subsequent measurement at December 31, 20X9		
	Dr	Impairment loss (surplus or deficit)	700,000
	Cr	Available-for-sale financial asset	700,000

Comparison with IAS 39

IPSAS 29, *Financial Instruments: Recognition and Measurement* is drawn primarily from IAS 39, *Financial Instruments: Recognition and Measurement* (including amendments up to December 31, 2008 as well as amendments made by the IASB to IAS 39 as part of its *Improvements to IFRSs* in April 2009). The main differences between IPSAS 29 and IAS 39 are as follows:

- IPSAS 29 contains additional application guidance to deal with concessionary loans and financial guarantee contracts entered into at nil or nominal consideration. IAS 39 does not deal with these areas.
- In certain instances, IPSAS 29 uses different terminology from IAS 39. The most significant examples are the use of the terms “statement of financial performance” and “net assets/equity.” The equivalent terms in IAS 39 are “statement of comprehensive income or separate income statement (if presented)” and “equity.”
- IPSAS 29 does not distinguish between “revenue” and “income.” IAS 39 distinguishes between “revenue and “income,” with “income” having a broader meaning than the term “revenue.”
- Principles from IFRIC 9, *Reassessment of Embedded Derivatives* and IFRIC 16 *Hedges of a Net Investment in a Foreign Operation* have been included as authoritative appendices to IPSAS 29. The IASB issues IFRICs as separate documents.

IPSAS 30—FINANCIAL INSTRUMENTS: DISCLOSURES

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Financial Reporting Standard (IFRS) 7, *Financial Instruments: Disclosures* published by the International Accounting Standards Board (IASB). Extracts from IFRS 7 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IFRSs, IASs, Exposure Drafts, and other publications of the IASB are copyright of the IFRS Foundation.

“IFRS,” “IAS,” “IASB,” “IFRS Foundation,” “International Accounting Standards,” and “International Financial Reporting Standards” are trademarks of the IFRS Foundation and should not be used without the approval of the IFRS Foundation.

IPSAS 30—FINANCIAL INSTRUMENTS: DISCLOSURES

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 15, 2014.

IPSAS 30, *Financial Instruments: Disclosures* was issued in January 2010.

Since then, IPSAS 30 has been amended by the following IPSASs:

- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 30

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011

IPSAS 30—FINANCIAL INSTRUMENTS: DISCLOSURES**CONTENTS**

	Paragraph
Objective	1–2
Scope	3–7
Definitions	8
Classes of Financial Instruments and Level of Disclosure	9
Significance of Financial Instruments for Financial Position and Financial Performance	10–37
Statement of Financial Position	11–23
Categories of Financial Assets and Financial Liabilities	11
Financial Assets or Financial Liabilities at Fair Value through Surplus or Deficit	12–14
Reclassification	15–16
Derecognition	17
Collateral	18–19
Allowance Account for Credit Losses	20
Compound Financial Instruments with Multiple Embedded Derivatives	21
Defaults and Breaches	22–23
Statement of Financial Performance	24
Items of Revenue, Expense, Gains, or Losses	24
Other Disclosures	25–37
Accounting Policies	25
Hedge Accounting	26–28
Fair Value	29–36
Concessionary Loans	37
Nature and Extent of Risks Arising from Financial Instruments	38–49
Qualitative Disclosures	40
Quantitative Disclosures	41–49

Credit Risk	43–45
Financial Assets that are Either Past Due or Impaired	44
Collateral and Other Credit Enhancements Obtained	45
Liquidity Risk	46
Market Risk	47–49
Sensitivity Analysis	47–48
Other Market Risk Disclosures	49
Effective Date and Transition	50–53
Withdrawal and Replacement of IPSAS 15 (2001)	54
Appendix A: Application Guidance	
Appendix B: Amendments to Other IPSASs	
Basis for Conclusions	
Implementation Guidance	
Comparison with IFRS 7	

International Public Sector Accounting Standard 30, *Financial Instruments: Disclosures*, is set out in paragraphs 1–54. All the paragraphs have equal authority. IPSAS 30 should be read in the context of its objective, the Basis for Conclusions, and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to require entities to provide disclosures in their financial statements that enable users to evaluate:
 - (a) The significance of financial instruments for the entity's financial position and performance; and
 - (b) The nature and extent of risks arising from financial instruments to which the entity is exposed during the period and at the end of the reporting period, and how the entity manages those risks.
2. The principles in this Standard complement the principles for recognizing, measuring, and presenting financial assets and financial liabilities in IPSAS 28, *Financial Instruments: Presentation* and IPSAS 29, *Financial Instruments: Recognition and Measurement*.

Scope

3. **This Standard shall be applied by all entities to all types of financial instruments, except:**
 - (a) **Those interests in controlled entities, associates, or joint ventures that are accounted for in accordance with IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates*, or IPSAS 8, *Interests in Joint Ventures*. However, in some cases, IPSAS 6, IPSAS 7, or IPSAS 8 permits an entity to account for an interest in a controlled entity, associate, or joint venture using IPSAS 29; in those cases, entities shall apply the requirements of this Standard. Entities shall also apply this Standard to all derivatives linked to interests in controlled entities, associates, or joint ventures unless the derivative meets the definition of an equity instrument in IPSAS 28.**
 - (b) **Employers' rights and obligations arising from employee benefit plans, to which IPSAS 25, *Employee Benefits* applies.**
 - (c) **Rights and obligations arising under insurance contracts. However, this Standard applies to:**
 - (i) **Derivatives that are embedded in insurance contracts if IPSAS 29 requires the entity to account for them separately; and**
 - (ii) **An issuer of financial guarantee contracts if the issuer applies IPSAS 29 in recognizing and measuring the contracts, but shall apply the relevant international or national accounting standard dealing with insurance contracts if the issuer elects to apply those standards in recognizing and measuring them.**

In addition to (i) and (ii) above, an entity may apply this Standard to insurance contracts which involve the transfer of financial risk.

- (d) **Financial instruments, contracts, and obligations under share-based payment transactions to which the relevant international or national accounting standard dealing with share-based payment applies, except for contracts within the scope of paragraphs 4–6 of IPSAS 29, to which that Standard applies.**
 - (e) **Instruments that are required to be classified as equity instruments in accordance with paragraphs 15 and 16 or paragraphs 17 and 18 of IPSAS 28.**
4. This Standard applies to recognized and unrecognized financial instruments. Recognized financial instruments include financial assets and financial liabilities that are within the scope of IPSAS 29. Unrecognized financial instruments include some financial instruments that, although outside the scope of IPSAS 29, are within the scope of this Standard (such as some loan commitments).
 5. This Standard applies to contracts to buy or sell a non-financial item that are within the scope of IPSAS 29 (see paragraphs 4–6 of IPSAS 29).
 6. **This Standard applies to all public sector entities other than Government Business Enterprises.**
 7. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.

Definitions

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

Credit risk is the risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.

Currency risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.

Interest rate risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.

Liquidity risk is the risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.

Loans payable are financial liabilities, other than short-term trade payables on normal credit terms.

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.

Other price risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.

A financial asset is **past due** when a counterparty has failed to make a payment when contractually due.

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

Classes of Financial Instruments and Level of Disclosure

9. When this Standard requires disclosures by class of financial instrument, an entity shall group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. An entity shall provide sufficient information to permit reconciliation to the line items presented in the statement of financial position.

Significance of Financial Instruments for Financial Position and Financial Performance

10. An entity shall disclose information that enables users of its financial statements to evaluate the significance of financial instruments for its financial position and performance.

Statement of Financial Position

Categories of Financial Assets and Financial Liabilities

11. The carrying amounts of each of the following categories, as defined in IPSAS 29, shall be disclosed either in the statement of financial position or in the notes:
 - (a) Financial assets at fair value through surplus or deficit, showing separately (i) those designated as such upon initial recognition, and (ii) those classified as held-for-trading in accordance with IPSAS 29;
 - (b) Held-to-maturity investments;

- (c) Loans and receivables;
- (d) Available-for-sale financial assets;
- (e) Financial liabilities at fair value through surplus or deficit, showing separately (i) those designated as such upon initial recognition, and (ii) those classified as held-for-trading in accordance with IPSAS 29; and
- (f) Financial liabilities measured at amortized cost.

Financial Assets or Financial Liabilities at Fair Value through Surplus or Deficit

12. If the entity has designated a loan or receivable (or group of loans or receivables) as at fair value through surplus or deficit, it shall disclose:
 - (a) The maximum exposure to credit risk (see paragraph 43(a)) of the loan or receivable (or group of loans or receivables) at the end of the reporting period.
 - (b) The amount by which any related credit derivatives or similar instruments mitigate that maximum exposure to credit risk.
 - (c) The amount of change, during the period and cumulatively, in the fair value of the loan or receivable (or group of loans or receivables) that is attributable to changes in the credit risk of the financial asset determined either:
 - (i) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk; or
 - (ii) Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the asset.

Changes in market conditions that give rise to market risk include changes in an observed (benchmark) interest rate, commodity price, foreign exchange rate, or index of prices or rates.
 - (d) The amount of the change in the fair value of any related credit derivatives or similar instruments that has occurred during the period and cumulatively since the loan or receivable was designated.
13. If the entity has designated a financial liability as at fair value through surplus or deficit in accordance with paragraph 10 of IPSAS 29, it shall disclose:
 - (a) The amount of change, during the period and cumulatively, in the fair value of the financial liability that is attributable to changes in the credit risk of that liability determined either:
 - (i) As the amount of change in its fair value that is not attributable to changes in market conditions that give rise to market risk (see Appendix A, paragraph AG4); or

- (ii) Using an alternative method the entity believes more faithfully represents the amount of change in its fair value that is attributable to changes in the credit risk of the liability.

Changes in market conditions that give rise to market risk include changes in a benchmark interest rate, the price of another entity's financial instrument, a commodity price, a foreign exchange rate, or an index of prices or rates. For contracts that include a unit-linking feature, changes in market conditions include changes in the performance of the related internal or external investment fund.

- (b) The difference between the financial liability's carrying amount and the amount the entity would be contractually required to pay at maturity to the holder of the obligation.

14. The entity shall disclose:

- (a) The methods used to comply with the requirements in paragraphs 12(c) and 13(a).
- (b) If the entity believes that the disclosure it has given to comply with the requirements in paragraph 12(c) or 13(a) does not faithfully represent the change in the fair value of the financial asset or financial liability attributable to changes in its credit risk, the reasons for reaching this conclusion and the factors it believes are relevant.

Reclassification

15. If the entity has reclassified a financial asset (in accordance with paragraphs 60–63 of IPSAS 29) as one measured:

- (a) At cost or amortized cost, rather than at fair value; or
- (b) At fair value, rather than at cost or amortized cost;

it shall disclose the amount reclassified into and out of each category and the reason for that reclassification.

16. If the entity has reclassified a financial asset out of the fair value through surplus or deficit category in accordance with paragraph 55 or 57 of IPSAS 29 or out of the available-for-sale category in accordance with paragraph 58 of IPSAS 29, it shall disclose:

- (a) The amount reclassified into and out of each category;
- (b) For each reporting period until derecognition, the carrying amounts and fair values of all financial assets that have been reclassified in the current and previous reporting periods;

- (c) If a financial asset was reclassified in accordance with paragraph 55 of IPSAS 29, the rare situation, and the facts and circumstances indicating that the situation was rare;
- (d) For the reporting period when the financial asset was reclassified, the fair value gain or loss on the financial asset recognized in surplus or deficit or in net assets/equity in that reporting period and in the previous reporting period;
- (e) For each reporting period following the reclassification (including the reporting period in which the financial asset was reclassified) until derecognition of the financial asset, the fair value gain or loss that would have been recognized in surplus or deficit or in net assets/equity if the financial asset had not been reclassified, and the gain, loss, revenue, and expense recognized in surplus or deficit; and
- (f) The effective interest rate and estimated amounts of cash flows the entity expects to recover, as at the date of reclassification of the financial asset.

Derecognition

17. An entity may have transferred financial assets in such a way that part or all of the financial assets do not qualify for derecognition (see paragraphs 17–39 of IPSAS 29). The entity shall disclose for each class of such financial assets:
 - (a) The nature of the assets;
 - (b) The nature of the risks and rewards of ownership to which the entity remains exposed;
 - (c) When the entity continues to recognize all of the assets, the carrying amounts of the assets, and of the associated liabilities; and
 - (d) When the entity continues to recognize the assets to the extent of its continuing involvement, the total carrying amount of the original assets, the amount of the assets that the entity continues to recognize, and the carrying amount of the associated liabilities.

Collateral

18. An entity shall disclose:
 - (a) The carrying amount of financial assets it has pledged as collateral for liabilities or contingent liabilities, including amounts that have been reclassified in accordance with paragraph 39(a) of IPSAS 29; and
 - (b) The terms and conditions relating to its pledge.

19. When an entity holds collateral (of financial or non-financial assets) and is permitted to sell or repledge the collateral in the absence of default by the owner of the collateral, it shall disclose:
- (a) The fair value of the collateral held;
 - (b) The fair value of any such collateral sold or repledged, and whether the entity has an obligation to return it; and
 - (c) The terms and conditions associated with its use of the collateral.

Allowance Account for Credit Losses

20. When financial assets are impaired by credit losses and the entity records the impairment in a separate account (e.g., an allowance account used to record individual impairments or a similar account used to record a collective impairment of assets) rather than directly reducing the carrying amount of the asset, it shall disclose a reconciliation of changes in that account during the period for each class of financial assets.

Compound Financial Instruments with Multiple Embedded Derivatives

21. If an entity has issued an instrument that contains both a liability and an equity component (see paragraph 33 of IPSAS 28) and the instrument has multiple embedded derivatives whose values are interdependent (such as a callable convertible debt instrument), it shall disclose the existence of those features.

Defaults and Breaches

22. For loans payable recognized at the end of the reporting period, an entity shall disclose:
- (a) Details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable;
 - (b) The carrying amount of the loans payable in default at the end of the reporting period; and
 - (c) Whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorized for issue.
23. If, during the period, there were breaches of loan agreement terms other than those described in paragraph 22, an entity shall disclose the same information as required by paragraph 22 if those breaches permitted the lender to demand accelerated repayment (unless the breaches were remedied, or the terms of the loan were renegotiated, on or before the end of the reporting period).

Statement of Financial Performance*Items of Revenue, Expense, Gains, or Losses*

24. An entity shall disclose the following items of revenue, expense, gains, or losses either in the statement of financial performance or in the notes:

- (a) Net gains or net losses on:
 - (i) Financial assets or financial liabilities at fair value through surplus or deficit, showing separately those on financial assets or financial liabilities designated as such upon initial recognition, and those on financial assets or financial liabilities that are classified as held for trading in accordance with IPSAS 29;
 - (ii) Available-for-sale financial assets, showing separately the amount of gain or loss recognized in net assets/equity during the period and the amount reclassified from net assets/equity and recognized directly in surplus or deficit for the period;
 - (iii) Held-to-maturity investments;
 - (iv) Loans and receivables; and
 - (v) Financial liabilities measured at amortized cost;
- (b) Total interest revenue and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through surplus or deficit;
- (c) Fee revenue and expense (other than amounts included in determining the effective interest rate) arising from:
 - (i) Financial assets or financial liabilities that are not at fair value through surplus or deficit; and
 - (ii) Trust and other fiduciary activities that result in the holding or investing of assets on behalf of individuals, trusts, retirement benefit plans, and other institutions;
- (d) Interest revenue on impaired financial assets accrued in accordance with paragraph AG126 of IPSAS 29; and
- (e) The amount of any impairment loss for each class of financial asset.

Other Disclosures*Accounting Policies*

25. In accordance with paragraph 132 of IPSAS 1, an entity discloses, in the summary of significant accounting policies, the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements.

Hedge Accounting

26. An entity shall disclose the following separately for each type of hedge described in IPSAS 29 (i.e., fair value hedges, cash flow hedges, and hedges of net investments in foreign operations):
 - (a) A description of each type of hedge;
 - (b) A description of the financial instruments designated as hedging instruments and their fair values at the end of the reporting period; and
 - (c) The nature of the risks being hedged.
27. For cash flow hedges, an entity shall disclose:
 - (a) The periods when the cash flows are expected to occur and when they are expected to affect surplus or deficit;
 - (b) A description of any forecast transaction for which hedge accounting had previously been used, but which is no longer expected to occur;
 - (c) The amount that was recognized in net assets/equity during the period;
 - (d) The amount that was reclassified from net assets/equity and included in surplus or deficit for the period, showing the amount included in each line item in the statement of financial performance; and
 - (e) The amount that was removed from net assets/equity during the period and included in the initial cost or other carrying amount of a non-financial asset or non-financial liability whose acquisition or incurrence was a hedge highly probable forecast transaction.
28. An entity shall disclose separately:
 - (a) In fair value hedges, gains or losses:
 - (i) On the hedging instrument; and
 - (ii) On the hedged item attributable to the hedged risk.
 - (b) The ineffectiveness recognized in surplus or deficit that arises from cash flow hedges; and
 - (c) The ineffectiveness recognized in surplus or deficit that arises from hedges of net investments in foreign operations.

Fair Value

29. Except as set out in paragraph 35 for each class of financial assets and financial liabilities (see paragraph 9), an entity shall disclose the fair value of that class of assets and liabilities in a way that permits it to be compared with its carrying amount.

30. In disclosing fair values, an entity shall group financial assets and financial liabilities into classes, but shall offset them only to the extent that their carrying amounts are offset in the statement of financial position.
31. An entity shall disclose for each class of financial instruments the methods and, when a valuation technique is used, the assumptions applied in determining fair values of each class of financial assets or financial liabilities. For example, if applicable, an entity discloses information about the assumptions relating to prepayment rates, rates of estimated credit losses, and interest rates or discount rates. If there has been a change in valuation technique, the entity shall disclose that change and the reasons for making it.
32. To make the disclosures required by paragraph 33 an entity shall classify fair value measurements using a fair value hierarchy that reflects the significance of the inputs used in making the measurements. The fair value hierarchy shall have the following levels:
 - (a) Quoted prices (unadjusted) in active markets for identical assets or liabilities (Level 1);
 - (b) Inputs other than quoted prices included within Level 1 that are observable for the asset or liability, either directly (i.e., as price) or indirectly (i.e., derived from prices) (Level 2); and
 - (c) Inputs for the asset or liability that are not based on observable market data (unobservable inputs) (Level 3).

The level in the fair value hierarchy within which the fair value measurement is categorized in its entirety shall be determined on the basis of the lowest level input that is significant to the fair value measurement in its entirety. For this purpose, the significance of an input is assessed against the fair value measurement in its entirety. If a fair value measurement uses observable inputs that require significant adjustment based on unobservable inputs, that measurement is a Level 3 measurement. Assessing the significance of a particular input to the fair value measurement in its entirety requires judgment, considering factors specific to the asset or liability.

33. For fair value measurements recognized in the statement of financial position an entity shall disclose for each class of financial instruments:
 - (a) The level in the fair value hierarchy into which the fair value measurements are categorized in their entirety, segregating fair value measurements in accordance with the levels defined in paragraph 32.
 - (b) Any significant transfers between Level 1 and Level 2 of the fair value hierarchy and the reasons for those transfers. Transfers into each level shall be disclosed and discussed separately from transfers out of each level. For this purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities.

- (c) For fair value measurements in Level 3, a reconciliation from the beginning balances to the ending balances, disclosing separately changes during the period attributable to the following:
 - (i) Total gains or losses for the period recognized in surplus or deficit, and a description of where they are presented in the statement of financial performance;
 - (ii) Total gains or losses recognized in net assets/equity;
 - (iii) Purchases, sales, issues, and settlements (each type of movement disclosed separately); and
 - (iv) Transfers into or out of Level 3 (e.g., transfers attributable to changes in the observability of market data) and the reasons for those transfers. For significant transfers, transfers into Level 3 shall be disclosed and discussed separately from transfers out of Level 3.
- (d) The amount of total gains or losses for the period in (c)(i) above included in surplus or deficit that are attributable to gains or losses relating to those assets and liabilities held at the end of the reporting period and a description of where those gains or losses are presented in the statement of financial performance.
- (e) For fair value measurements in Level 3, if changing one or more of the inputs to reasonably possible alternative assumptions would change fair value significantly, the entity shall state that fact and disclose the effect of those changes. The entity shall disclose how the effect of a change to a reasonably possible alternative assumption was calculated. For this purpose, significance shall be judged with respect to surplus or deficit, and total assets or total liabilities, or, when changes in fair value are recognized in net assets/equity, total equity.

An entity shall present the quantitative disclosures required by this paragraph in tabular format unless another format is more appropriate.

34. If the market for a financial instrument is not active, an entity establishes its fair value using a valuation technique (see paragraphs AG106–AG112 of IPSAS 29). Nevertheless, the best evidence of fair value at initial recognition is the transaction price (i.e., the fair value of the consideration given or received), unless conditions described in paragraph AG108 of IPSAS 29 are met. It follows that there could be a difference between the fair value at initial recognition and the amount that would be determined at that date using the valuation technique. If such a difference exists, an entity shall disclose, by class of financial instrument:
 - (a) Its accounting policy for recognizing that difference in surplus or deficit to reflect a change in factors (including time) that market

participants would consider in setting a price (see paragraph AG109 of IPSAS 29); and

- (b) The aggregate difference yet to be recognized in surplus or deficit at the beginning and end of the period and a reconciliation of changes in the balance of this difference.
35. Disclosures of fair value are not required:
- (a) When the carrying amount is a reasonable approximation of fair value, for example, for financial instruments such as short-term trade receivables and payables;
 - (b) For an investment in equity instruments that do not have a quoted market price in an active market, or derivatives linked to such equity instruments, that is measured at cost in accordance with IPSAS 29 because its fair value cannot be measured reliably; and
 - (c) For a contract containing a discretionary participation feature if the fair value of that feature cannot be measured reliably.
36. In the cases described in paragraph 35(b) and (c), an entity shall disclose information to help users of the financial statements make their own judgments about the extent of possible differences between the carrying amount of those financial assets or financial liabilities and their fair value, including:
- (a) The fact that fair value information has not been disclosed for these instruments because their fair value cannot be measured reliably;
 - (b) A description of the financial instruments, their carrying amount, and an explanation of why fair value cannot be measured reliably;
 - (c) Information about the market for the instruments;
 - (d) Information about whether and how the entity intends to dispose of the financial instruments; and
 - (e) If financial instruments whose fair value previously could not be reliably measured are derecognized, that fact, their carrying amount at the time of derecognition, and the amount of gain or loss recognized.

Concessionary Loans

37. Concessionary loans are granted by entities on below market terms. Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. For concessionary loans granted an entity shall disclose:

- (a) A reconciliation between the opening and closing carrying amounts of the loans, including:
 - (i) Nominal value of new loans granted during the period;
 - (ii) The fair value adjustment on initial recognition;
 - (iii) Loans repaid during the period;
 - (iv) Impairment losses recognized;
 - (v) Any increase during the period in the discounted amount arising from the passage of time; and
 - (vi) Other changes.
- (b) Nominal value of the loans at the end of the period;
- (c) The purpose and terms of the various types of loans; and
- (d) Valuation assumptions.

Nature and Extent of Risks Arising from Financial Instruments

- 38. **An entity shall disclose information that enables users of its financial statements to evaluate the nature and extent of risks arising from financial instruments to which the entity is exposed at the end of the reporting period.**
- 39. The disclosures required by paragraphs 40–49 focus on the risks that arise from financial instruments and how they have been managed. These risks typically include, but are not limited to, credit risk, liquidity risk, and market risk.

Qualitative Disclosures

- 40. For each type of risk arising from financial instruments, an entity shall disclose:
 - (a) The exposures to risk and how they arise;
 - (b) Its objectives, policies, and processes for managing the risk and the methods used to measure the risk; and
 - (c) Any changes in (a) or (b) from the previous period.

Quantitative Disclosures

- 41. For each type of risk arising from financial instruments, an entity shall disclose:
 - (a) Summary quantitative data about its exposure to that risk at the end of the reporting period. This disclosure shall be based on the information provided internally to key management personnel of the entity (as

defined in IPSAS 20, *Related Party Disclosures*), for example, the entity's governing body or chief executive officer.

- (b) The disclosures required by paragraphs 43–49, to the extent not provided in (a), unless the risk is not material (see paragraphs 45–47 of IPSAS 1 for a discussion of materiality).
 - (c) Concentrations of risk if not apparent from (a) and (b).
42. If the quantitative data disclosed as at the end of the reporting period are unrepresentative of an entity's exposure to risk during the period, an entity shall provide further information that is representative.

Credit Risk

43. An entity shall disclose by class of financial instrument:
- (a) The amount that best represents its maximum exposure to credit risk at the end of the reporting period without taking account of any collateral held or other credit enhancements (e.g., netting agreements that do not qualify for offset in accordance with IPSAS 28);
 - (b) In respect of the amount disclosed in (a), a description of collateral held as security and other credit enhancements;
 - (c) Information about the credit quality of financial assets that are neither past due nor impaired; and
 - (d) The carrying amount of financial assets that would otherwise be past due or impaired whose terms have been renegotiated.

Financial Assets that are Either Past Due or Impaired

44. An entity shall disclose by class of financial asset:
- (a) An analysis of the age of financial assets that are past due as at the end of the reporting period but not impaired;
 - (b) An analysis of financial assets that are individually determined to be impaired as at the end of the reporting period, including the factors the entity considered in determining that they are impaired; and
 - (c) For the amounts disclosed in (a) and (b), a description of collateral held by the entity as security and other credit enhancements and, unless impracticable, an estimate of their fair value.

Collateral and Other Credit Enhancements Obtained

45. When an entity obtains financial or non-financial assets during the period by taking possession of collateral it holds as security or calling on other credit enhancements (e.g., guarantees), and such assets meet the recognition criteria in other Standards, an entity shall disclose:

- (a) The nature and carrying amount of the assets obtained; and
- (b) When the assets are not readily convertible into cash, its policies for disposing of such assets or for using them in its operations.

Liquidity Risk

46. An entity shall disclose:

- (a) A maturity analysis for non-derivative financial liabilities (including issued financial guarantee contracts) that shows the remaining contractual maturities.
- (b) A maturity analysis for derivative financial liabilities. The maturity analysis shall include the remaining contractual maturities for those derivative financial liabilities for which contractual maturities are essential for an understanding of the timing of the cash flows (see paragraph AG14).
- (c) A description of how it manages the liquidity risk inherent in (a) and (b).

Market Risk

Sensitivity Analysis

47. Unless an entity complies with paragraph 48, it shall disclose:

- (a) A sensitivity analysis for each type of market risk to which the entity is exposed at the end of the reporting period, showing how surplus or deficit and net assets/equity would have been affected by changes in the relevant risk variable that were reasonably possible at that date;
- (b) The methods and assumptions used in preparing the sensitivity analysis; and
- (c) Changes from the previous period in the methods and assumptions used, and the reasons for such changes.

48. If an entity prepares a sensitivity analysis, such as value-at-risk, that reflects interdependencies between risk variables (e.g., interest rates and exchange rates) and uses it to manage financial risks, it may use that sensitivity analysis in place of the analysis specified in paragraph 47. The entity shall also disclose:

- (a) An explanation of the method used in preparing such a sensitivity analysis, and of the main parameters and assumptions underlying the data provided; and
- (b) An explanation of the objective of the method used and of limitations that may result in the information not fully reflecting the fair value of the assets and liabilities involved.

Other Market Risk Disclosures

49. When the sensitivity analyses disclosed in accordance with paragraph 47 or 48 are unrepresentative of a risk inherent in a financial instrument (e.g., because the year-end exposure does not reflect the exposure during the year), the entity shall disclose that fact and the reason it believes the sensitivity analyses are unrepresentative.

Effective Date and Transition

50. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2013. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2013, it shall disclose that fact.**
51. **An entity shall not apply this Standard before January 1, 2013, unless it also applies IPSAS 28 and IPSAS 29.**
52. If an entity applies this Standard for annual periods beginning before January 1, 2013, it need not present comparative information for the disclosures required by paragraphs 38–49 about the nature and extent of risks arising from financial instruments.
53. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Withdrawal and Replacement of IPSAS 15 (2001)

54. This Standard and IPSAS 28 supersede IPSAS 15, *Financial Instruments: Disclosure and Presentation* issued in 2001. IPSAS 15 remains applicable until IPSAS 28 and IPSAS 30 are applied or become effective, whichever is earlier.

Appendix A

Application Guidance

This appendix is an integral part of IPSAS 30.

Classes of Financial Instruments and Level of Disclosure (paragraph 9)

- AG1. Paragraph 9 requires an entity to group financial instruments into classes that are appropriate to the nature of the information disclosed and that take into account the characteristics of those financial instruments. The classes described in paragraph 9 are determined by the entity and are, thus, distinct from the categories of financial instruments specified in IPSAS 29 (which determine how financial instruments are measured and where changes in fair value are recognized).
- AG2. In determining classes of financial instrument, an entity shall, at a minimum:
- (a) Distinguish instruments measured at amortized cost from those measured at fair value.
 - (b) Treat as a separate class or classes those financial instruments outside the scope of this Standard.
- AG3. An entity decides, in the light of its circumstances, how much detail it provides to satisfy the requirements of this Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics. It is necessary to strike a balance between overburdening financial statements with excessive detail that may not assist users of financial statements and obscuring important information as a result of too much aggregation. For example, an entity shall not obscure important information by including it among a large amount of insignificant detail. Similarly, an entity shall not disclose information that is so aggregated that it obscures important differences between individual transactions or associated risks.

Significance of Financial Instruments for Financial Position and Financial Performance

Financial Liabilities at Fair Value through Surplus or Deficit (paragraphs 13 and 14)

- AG4. If an entity designates a financial liability as at fair value through surplus or deficit, paragraph 13(a) requires it to disclose the amount of change in the fair value of the financial liability that is attributable to changes in the liability's credit risk. Paragraph 13(a)(i) permits an entity to determine this amount as the amount of change in the liability's fair value that is not

attributable to changes in market conditions that give rise to market risk. If the only relevant changes in market conditions for a liability are changes in an observed (benchmark) interest rate, this amount can be estimated as follows:

- (a) First, the entity computes the liability's internal rate of return at the start of the period using the observed market price of the liability and the liability's contractual cash flows at the start of the period. It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an instrument-specific component of the internal rate of return.
- (b) Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period, and (ii) the instrument-specific component of the internal rate of return as determined in (a).
- (c) The difference between the observed market price of the liability at the end of the period and the amount determined in (b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.

This example assumes that changes in fair value arising from factors other than changes in the instrument's credit risk or changes in interest rates are not significant. If the instrument in the example contains an embedded derivative, the change in fair value of the embedded derivative is excluded in determining the amount to be disclosed in accordance with paragraph 13(a).

Other Disclosure—Accounting Policies (paragraph 25)

AG5. Paragraph 25 requires disclosure of the measurement basis (or bases) used in preparing the financial statements and the other accounting policies used that are relevant to an understanding of the financial statements. For financial instruments, such disclosure may include:

- (a) For financial assets or financial liabilities designated as at fair value through surplus or deficit:
 - (i) The nature of the financial assets or financial liabilities the entity has designated as at fair value through surplus or deficit;
 - (ii) The criteria for so designating such financial assets or financial liabilities on initial recognition; and

- (iii) How the entity has satisfied the conditions in paragraph 10, 13, or 14 of IPSAS 29 for such designation. For instruments designated in accordance with paragraph (b)(i) of the definition of a financial asset or financial liability at fair value through surplus or deficit in IPSAS 29, that disclosure includes a narrative description of the circumstances underlying the measurement or recognition inconsistency that would otherwise arise. For instruments designated in accordance with paragraph (b)(ii) of the definition of a financial asset or financial liability at fair value through surplus or deficit in IPSAS 29, that disclosure includes a narrative description of how designation at fair value through surplus or deficit is consistent with the entity's documented risk management or investment strategy.
- (b) The criteria for designating financial assets as available for sale.
- (c) Whether regular way purchases and sales of financial assets are accounted for at trade date or at settlement date (see paragraph 40 of IPSAS 29).
- (d) When an allowance account is used to reduce the carrying amount of financial assets impaired by credit losses:
 - (i) The criteria for determining when the carrying amount of impaired financial assets is reduced directly (or, in the case of a reversal of a write-down, increased directly) and when the allowance account is used; and
 - (ii) The criteria for writing off amounts charged to the allowance account against the carrying amount of impaired financial assets (see paragraph 20).
- (e) How net gains or net losses on each category of financial instrument are determined (see paragraph 24(a)), for example, whether the net gains or net losses on items at fair value through surplus or deficit include interest or revenue from dividends or similar distributions.
- (f) The criteria the entity uses to determine that there is objective evidence that an impairment loss has occurred (see paragraph 24(e)).
- (g) When the terms of financial assets that would otherwise be past due or impaired have been renegotiated, the accounting policy for financial assets that are the subject of renegotiated terms (see paragraph 43(d)).
- (h) For financial guarantee contracts issued through a non-exchange transaction, where no fair value can be determined and a provision is recognized in accordance with IPSAS 19, *Provisions, Contingent*

Liabilities and Contingent Assets, disclosure of the circumstances that result in a provision being recognized.

Paragraph 137 of IPSAS 1 also requires entities to disclose, in the summary of significant accounting policies or other notes, the judgments, apart from those involving estimations, that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognized in the financial statements.

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49)

AG6. The disclosures required by paragraphs 38–49 shall be either given in the financial statements or incorporated by cross-reference from the financial statements to some other statement, such as a management commentary or risk report, that is available to users of the financial statements on the same terms as the financial statements and at the same time. Without the information incorporated by cross-reference, the financial statements are incomplete.

Quantitative Disclosures (paragraph 41)

AG7. Paragraph 41(a) requires disclosures of summary quantitative data about an entity's exposure to risks based on the information provided internally to key management personnel of the entity. When an entity uses several methods to manage a risk exposure, the entity shall disclose information using the method or methods that provide the most relevant and reliable information. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* discusses relevance and reliability.

AG8. Paragraph 41(c) requires disclosures about concentrations of risk. Concentrations of risk arise from financial instruments that have similar characteristics and are affected similarly by changes in economic or other conditions. The identification of concentrations of risk requires judgment taking into account the circumstances of the entity. Disclosure of concentrations of risk shall include:

- (a) A description of how management determines concentrations;
- (b) A description of the shared characteristic that identifies each concentration (e.g., counterparty, geographical area, currency, or market); and
- (c) The amount of the risk exposure associated with all financial instruments sharing that characteristic.

Maximum Credit Risk Exposure (paragraph 43(a))

AG9. Paragraph 43(a) requires disclosure of the amount that best represents the entity's maximum exposure to credit risk. For a financial asset, this is typically the gross carrying amount, net of:

- (a) Any amounts offset in accordance with IPSAS 28; and
- (b) Any impairment losses recognized in accordance with IPSAS 29.

AG10. Activities that give rise to credit risk and the associated maximum exposure to credit risk include, but are not limited to:

- (a) Granting loans and receivables to customers and placing deposits with other entities. In these cases, the maximum exposure to credit risk is the carrying amount of the related financial assets.
- (b) Entering into derivative contracts (e.g., foreign exchange contracts, interest rate swaps, and credit derivatives). When the resulting asset is measured at fair value, the maximum exposure to credit risk at the end of the reporting period will equal the carrying amount.
- (c) Granting financial guarantees. In this case, the maximum exposure to credit risk is the maximum amount the entity could have to pay if the guarantee is called on, which may be significantly greater than the amount recognized as a liability.
- (d) Making a loan commitment that is irrevocable over the life of the facility or is revocable only in response to a material adverse change. If the issuer cannot settle the loan commitment net in cash or another financial instrument, the maximum credit exposure is the full amount of the commitment. This is because it is uncertain whether the amount of any undrawn portion may be drawn upon in the future. This may be significantly greater than the amount recognized as a liability.

Quantitative Liquidity Risk Disclosures (paragraphs 41(a), and 46(a) and (b))

AG11. In accordance with paragraph 41(a) an entity discloses summary quantitative data about its exposure to liquidity risk on the basis of the information provided internally to key management personnel. An entity shall explain how those data are determined. If the outflows of cash (or another financial asset) included in those data could either:

- (a) Occur significantly earlier than indicated in the data; or
- (b) Be for significantly different amounts from those indicated in the data (e.g., for a derivative that is included in the data on a net settlement basis but for which the counterparty has the option to require gross settlement);

the entity shall state that fact and provide quantitative information that enables users of its financial statements to evaluate the extent of this risk unless that information is included in the contractual maturity analyses required by paragraph 46(a) or (b).

- AG12. In preparing the maturity analyses required by paragraph 46(a) and (b), an entity uses its judgment to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:
- (a) Not later than one month;
 - (b) Later than one month and not later than three months;
 - (c) Later than three months and not later than one year; and
 - (d) Later than one year and not later than five years.
- AG13. In complying with paragraph 46(a) and (b), an entity shall not separate an embedded derivative from a hybrid (combined) instrument. For such an instrument, an entity shall apply paragraph 46(a).
- AG14. Paragraph 46(b) requires an entity to disclose a quantitative maturity analysis for derivative financial liabilities that shows remaining contractual maturities if the contractual maturities are essential for an understanding of the timing of the cash flows. For example, this would be the case for:
- (a) An interest rate swap with a remaining maturity of five years in a cash flow hedge of a variable rate financial asset or liability.
 - (b) All loan commitments.
- AG15. Paragraph 46(a) and (b) requires an entity to disclose maturity analyses for financial liabilities that show the remaining contractual maturities for some financial liabilities. In this disclosure:
- (a) When a counterparty has a choice of when an amount is paid, the liability is allocated to the earliest period in which the entity can be required to pay. For example, financial liabilities that an entity can be required to repay on demand (e.g., demand deposits) are included in the earliest time band.
 - (b) When an entity is committed to make amounts available in instalments, each instalment is allocated to the earliest period in which the entity can be required to pay. For example, an undrawn loan commitment is included in the time band containing the earliest date it can be drawn down.
 - (c) For issued financial guarantee contracts the maximum amount of the guarantee is allocated to the earliest period in which the guarantee could be called.

AG16. The contractual amounts disclosed in the maturity analyses as required by paragraph 46(a) and (b) are the contractual undiscounted cash flows, for example:

- (a) Gross finance lease obligations (before deducting finance charges);
- (b) Prices specified in forward agreements to purchase financial assets for cash;
- (c) Net amounts for pay-floating/receive-fixed interest rate swaps for which net cash flows are exchanged;
- (d) Contractual amounts to be exchanged in a derivative financial instrument (e.g., a currency swap) for which gross cash flows are exchanged; and
- (e) Gross loan commitments.

Such undiscounted cash flows differ from the amount included in the statement of financial position because the amount in that statement is based on discounted cash flows. When the amount payable is not fixed, the amount disclosed is determined by reference to the conditions existing at the end of the reporting period. For example, when the amount payable varies with changes in an index, the amount disclosed may be based on the level of the index at the end of the period.

AG17. Paragraph 46(c) requires an entity to describe how it manages the liquidity risk inherent in the items disclosed in the quantitative disclosures required in paragraph 40(a) and (b). An entity shall disclose a maturity analysis of financial assets it holds for managing liquidity risk (e.g., financial assets that are readily saleable or expected to generate cash inflows to meet cash outflows on financial liabilities), if that information is necessary to enable users of its financial statements to evaluate the nature and extent of liquidity risk.

AG18. Other factors that an entity might consider in providing the disclosure required in paragraph 40(c) include, but are not limited to, whether the entity:

- (a) Has committed borrowing facilities (e.g., commercial paper facilities) or other lines of credit (e.g., stand-by credit facilities) that it can access to meet liquidity needs;
- (b) Holds deposits at central banks to meet liquidity needs;
- (c) Has very diverse funding sources;
- (d) Has significant concentrations of liquidity risk in either its assets or its funding sources;

- (e) Has internal control processes and contingency plans for managing liquidity risk;
- (f) Has instruments that include accelerated repayment terms (e.g., on the downgrade of the entity's credit rating);
- (g) Has instruments that could require the posting of collateral (e.g., margin calls for derivatives);
- (h) Has instruments that allows the entity to choose whether it settles its financial liabilities by delivering cash (or another financial asset) or by delivering its own shares; or
- (i) Has instruments that are subject to master netting agreements.

Market Risk—Sensitivity Analysis (paragraphs 47 and 48)

AG19. Paragraph 47(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. In accordance with paragraph AG3, an entity decides how it aggregates information to display the overall picture without combining information with different characteristics about exposures to risks from significantly different economic environments. For example:

- (a) An entity that trades financial instruments might disclose this information separately for financial instruments held for trading and those not held for trading.
- (b) An entity would not aggregate its exposure to market risks from areas of hyperinflation with its exposure to the same market risks from areas of very low inflation.

If an entity has exposure to only one type of market risk in only one economic environment, it would not show disaggregated information.

AG20. Paragraph 47(a) requires the sensitivity analysis to show the effect on surplus or deficit and net assets/equity of reasonably possible changes in the relevant risk variable (e.g., prevailing market interest rates, currency rates, equity prices, or commodity prices). For this purpose:

- (a) Entities are not required to determine what the surplus or deficit for the period would have been if relevant risk variables had been different. Instead, entities disclose the effect on surplus or deficit and net assets/equity at the end of the reporting period assuming that a reasonably possible change in the relevant risk variable had occurred at the end of the reporting period and had been applied to the risk exposures in existence at that date. For example, if an entity has a floating rate liability at the end of the year, the entity would disclose the effect on surplus or deficit (i.e., interest expense) for the current year if interest rates had varied by reasonably possible amounts.

- (b) Entities are not required to disclose the effect on surplus or deficit and net assets/equity for each change within a range of reasonably possible changes of the relevant risk variable. Disclosure of the effects of the changes at the limits of the reasonably possible range would be sufficient.

AG21. In determining what a reasonably possible change in the relevant risk variable is, an entity should consider:

- (a) The economic environments in which it operates. A reasonably possible change should not include remote or “worst case” scenarios or “stress tests”. Moreover, if the rate of change in the underlying risk variable is stable, the entity need not alter the chosen reasonably possible change in the risk variable. For example, assume that interest rates are 5 percent and an entity determines that a fluctuation in interest rates of ± 50 basis points is reasonably possible. It would disclose the effect on surplus or deficit and net assets/equity if interest rates were to change to 4.5 percent or 5.5 percent. In the next period, interest rates have increased to 5.5 percent. The entity continues to believe that interest rates may fluctuate by ± 50 basis points (i.e., that the rate of change in interest rates is stable). The entity would disclose the effect on surplus or deficit and net assets/equity if interest rates were to change to 5 percent or 6 percent. The entity would not be required to revise its assessment that interest rates might reasonably fluctuate by ± 50 basis points, unless there is evidence that interest rates have become significantly more volatile.
- (b) The time frame over which it is making the assessment. The sensitivity analysis shall show the effects of changes that are considered to be reasonably possible over the period until the entity will next present these disclosures, which is usually its next annual reporting period.

AG22. Paragraph 48 permits an entity to use a sensitivity analysis that reflects interdependencies between risk variables, such as a value-at-risk methodology, if it uses this analysis to manage its exposure to financial risks. This applies even if such a methodology measures only the potential for loss and does not measure the potential for gain. Such an entity might comply with paragraph 48(a) by disclosing the type of value-at-risk model used (e.g., whether the model relies on Monte Carlo simulations), an explanation about how the model works and the main assumptions (e.g., the holding period and confidence level). Entities might also disclose the historical observation period and weightings applied to observations within that period, an explanation of how options are dealt with in the calculations, and which volatilities and correlations (or, alternatively, Monte Carlo probability distribution simulations) are used.

- AG23. An entity shall provide sensitivity analyses for the whole of its operations, but may provide different types of sensitivity analysis for different classes of financial instruments.

Interest Rate Risk

- AG24. Interest rate risk arises on interest-bearing financial instruments recognized in the statement of financial position (e.g., loans and receivables and debt instruments issued) and on some financial instruments not recognized in the statement of financial position (e.g., some loan commitments).

Currency Risk

- AG25. Currency risk (or foreign exchange risk) arises on financial instruments that are denominated in a foreign currency (i.e., in a currency other than the functional currency in which they are measured). For the purpose of this Standard, currency risk does not arise from financial instruments that are non-monetary items or from financial instruments denominated in the functional currency.
- AG26. A sensitivity analysis is disclosed for each currency to which an entity has significant exposure.

Other Price Risk

- AG27. Other price risk arises on financial instruments because of changes in, for example, commodity prices or equity prices. To comply with paragraph 47, an entity might disclose the effect of a decrease in a specified stock market index, commodity price, or other risk variable. For example, if an entity gives residual value guarantees that are financial instruments, the entity discloses an increase or decrease in the value of the assets to which the guarantee applies.
- AG28. Two examples of financial instruments that give rise to equity price risk are (a) a holding of equities in another entity, and (b) an investment in a trust that in turn holds investments in equity instruments. Other examples include forward contracts and options to buy or sell specified quantities of an equity instrument and swaps that are indexed to equity prices. The fair values of such financial instruments are affected by changes in the market price of the underlying equity instruments.
- AG29. In accordance with paragraph 47(a), the sensitivity of surplus or deficit (that arises, for example, from instruments classified as at fair value through surplus or deficit and impairments of available-for-sale financial assets) is disclosed separately from the sensitivity of net assets/equity (that arises, for example, from instruments classified as available for sale).
- AG30. Financial instruments that an entity classifies as equity instruments are not remeasured. Neither surplus or deficit nor net assets/equity will be affected

by the equity price risk of those instruments. Accordingly, no sensitivity analysis is required.

Amendments to Other IPSASs

IPSAS 1, *Presentation of Financial Statements*

Paragraph 75 is amended as follows:

75. Information about expected dates of realization of assets and liabilities is useful in assessing the liquidity and solvency of an entity. ~~IPSAS 15, “Financial Instruments: Disclosure and Presentation”~~ IPSAS 30, *Financial Instruments: Disclosures* requires disclosure of the maturity dates of financial assets and financial liabilities. Financial assets include trade and other receivables and financial liabilities include trade and other payables. Information on the expected date of recovery and settlement of non-monetary assets and liabilities such as inventories and provisions is also useful, whether or not assets and liabilities are classified as current or non-current.

Paragraph 129(d)(ii) is amended as follows:

129. ...
- (d) ...
- (ii) ~~Non-financial disclosures, e.g., the entity’s financial risk management objectives and policies (see IPSAS 15 IPSAS 30).~~

Paragraph 148 is amended as follows:

148. The disclosure of some of the key assumptions that would otherwise be required in accordance with paragraph 140 is required by other Standards. For example, IPSAS 19 requires disclosure, in specified circumstances, of major assumptions concerning future events affecting classes of provisions. ~~IPSAS 15~~ IPSAS 30 requires disclosure of significant assumptions applied in estimating fair values of financial assets and financial liabilities that are carried at fair value. IPSAS 17 requires disclosure of significant assumptions applied in estimating fair values of revalued items of property, plant and equipment.

A new heading and paragraphs are inserted after paragraph 148 as follows:

Capital

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

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

- (a) Qualitative information about its objectives, policies, and processes for managing capital, including (but not limited to):
 - (i) A description of what it manages as capital;
 - (ii) When an entity is subject to externally imposed capital requirements, the nature of those requirements and how those requirements are incorporated into the management of capital; and
 - (iii) How it is meeting its objectives for managing capital.
- (b) Summary quantitative data about what it manages as capital. Some entities regard some financial liabilities (e.g., some forms of subordinated debt) as part of capital. Other entities regard capital as excluding some components of equity (e.g., components arising from cash flow hedges).
- (c) Any changes in (a) and (b) from the previous period.
- (d) Whether during the period it complied with any externally imposed capital requirements to which it is subject.
- (e) When the entity has not complied with such externally imposed capital requirements, the consequences of such non-compliance.

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

148C. An entity may manage capital in a number of ways and be subject to a number of different capital requirements. For example, a conglomerate may include entities that undertake insurance activities and banking activities, and those entities may also operate in several jurisdictions. When an aggregate disclosure of capital requirements and how capital is managed would provide useful information or distorts a financial statement user's understanding of an entity's capital resources, the entity shall disclose separate information for each capital requirement to which the entity is subject.

A new paragraph is inserted after paragraph 153B as follows:

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

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 30.

Introduction

- BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 30, *Financial Instruments: Disclosures*. As this Standard is based on IFRS 7, *Financial Instruments: Disclosures* issued by the IASB, the Basis for Conclusions outlines only those areas where IPSAS 30 departs from the main requirements of IFRS 7.
- BC2. This project on financial instruments is noted as a key part of the IPSASB's convergence program which aims to converge IPSASs with IFRSs.
- BC3. In developing this Standard, the IPSASB agreed to retain the existing text of IFRS 7 wherever consistent with existing IPSASs, except to deal with any public sector specific issues which result in adding or deleting disclosures.
- BC4. In September 2007, the IASB issued amendments to IAS 1, *Presentation of Financial Statements* which introduced a new component into the presentation of financial statements called "comprehensive income." As the IPSASB has not yet considered this, along with some of the other amendments proposed in IAS 1, those amendments have not been included in IPSAS 30.

Concessionary Loans

- BC5. Concessionary loans are granted to or received by an entity on below market terms. Examples of concessionary loans granted by entities include loans to developing countries, small farms, student loans granted to qualifying students for university or college education, and housing loans granted to low income families. Such loans are a feature of the public sector and are often made to implement a government's or other public sector entity's social policies. The intention of a concessionary loan at the outset is to provide or receive resources on below market terms. For this reason, the IPSASB concluded that more comprehensive disclosures are required by public sector entities for concessionary loans and has included additional disclosure requirements for such loans in paragraph 37.

IMPLEMENTATION GUIDANCE

CONTENTS

	Paragraph
Introduction	IG1–IG4
Materiality	IG3–IG4
Classes of Financial Instruments and Level of Disclosure	IG5–IG6
Significance of Financial Instruments for Financial Position and	
Financial Performance	IG7–IG16
Financial Liabilities at Fair Value through Surplus or Deficit	IG7–IG11
Defaults and Breaches	IG12
Total Interest Expense	IG13
Fair Value	IG14–IG16
Nature and Extent of Risks Arising from Financial Instruments	IG17–IG40
Qualitative Disclosures	IG17–IG19
Quantitative Disclosures	IG20–IG40
Credit Risk	IG23–IG31
Collateral and Other Credit Enhancements Pledged	IG24
Credit Quality	IG25–IG27
Financial Assets that are either Past Due or Impaired	IG28–IG31
Market Risk	IG32–IG40
Other Market Risk Disclosures	IG37–IG40

Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 30.

Introduction

- IG1. This guidance suggests possible ways to apply some of the disclosure requirements in IPSAS 30. The guidance does not create additional requirements.
- IG2. For convenience, each disclosure requirement in this Standard is discussed separately. In practice, disclosures would normally be presented as an integrated package and individual disclosures might satisfy more than one requirement. For example, information about concentrations of risk might also convey information about exposure to credit or other risk.

Materiality

- IG3. IPSAS 1 notes that a specific disclosure requirement in an IPSAS need not be satisfied if the information is not material. IPSAS 1 defines materiality as follows:

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

- IG4. IPSAS 1 also explains that definition as follows:

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

Classes of Financial Instruments and Level of Disclosure (paragraphs 9 and AG1–AG3)

- IG5. Paragraph AG3 states that “an entity decides in the light of its circumstances how much detail it provides to satisfy the requirements of this Standard, how much emphasis it places on different aspects of the requirements and how it aggregates information to display the overall picture without combining information with different characteristics.” To satisfy the requirements, an entity may not need to disclose all the information suggested in this guidance.

- IG6. Paragraph 29(c) of IPSAS 1 requires an entity to “provide additional disclosures when compliance with the specific requirements in IPSASs is insufficient to enable users to understand the impact of particular transactions, other events and conditions on the entity’s financial position and financial performance.”

Significance of Financial Instruments for Financial Position and Financial Performance (paragraphs 10–36, AG4 and AG5)

Financial Liabilities at Fair Value through Surplus or Deficit (paragraphs 13(a)(i) and AG4)

- IG7. The following example illustrates the calculation that an entity might perform in accordance with paragraph AG4 of Appendix A of the Standard.
- IG8. On January 1, 20X1, an entity issues a 10-year bond with a par value of CU150,000¹ and an annual fixed coupon rate of 8 percent, which is consistent with market rates for bonds with similar characteristics.
- IG9. The entity uses the London Interbank Offered Rate (LIBOR) as its observable (benchmark) interest rate. At the date of inception of the bond, LIBOR is 5 percent. At the end of the first year:
- (a) LIBOR has decreased to 4.75 percent.
 - (b) The fair value for the bond is CU153,811, consistent with an interest rate of 7.6 percent.²
- IG10. The entity assumes a flat yield curve, all changes in interest rates result from a parallel shift in the yield curve, and the changes in LIBOR are the only relevant changes in market conditions.
- IG11. The entity estimates the amount of change in the fair value of the bond that is not attributable to changes in market conditions that give rise to market risk as follows:

<p>[paragraph AG4(a)]</p> <p>First, the entity computes the liability’s internal rate of return at the start of the period using the observed market price of the liability and the liability’s contractual cash flows at the start of the period.</p> <p>It deducts from this rate of return the observed (benchmark) interest rate at the start of the period, to arrive at an</p>	<p>At the start of the period of a 10-year bond with a coupon of 8 percent, the bond’s internal rate of return is 8 percent.</p> <p>Because the observed (benchmark) interest rate (LIBOR) is 5 percent, the instrument-specific component of the internal rate of return is 3 percent.</p>
--	---

¹ In this guidance monetary amounts are denominated in “currency units (CU).”

² This reflects a shift in LIBOR from 5 percent to 4.75 percent and a movement of 0.15 percent which, in the absence of other relevant changes in market conditions, is assumed to reflect changes in credit risk of the instrument.

instrument-specific component of the internal rate of return.	
<p>[paragraph AG4(b)]</p> <p>Next, the entity calculates the present value of the cash flows associated with the liability using the liability's contractual cash flows at the end of the period and a discount rate equal to the sum of (i) the observed (benchmark) interest rate at the end of the period, and (ii) the instrument-specific component of the internal rate of return as determined in accordance with paragraph AG4(a).</p>	<p>The contractual cash flows of the instrument at the end of the period are:</p> <ul style="list-style-type: none"> Interest: CU12,000^(a) per year for each of years 2–10. Principal: CU150,000 in year 10. <p>The discount rate to be used to calculate the present value of the bond is thus 7.75 percent, which is 4.75 percent end of period LIBOR rate, plus the 3 percent instrument-specific component.</p> <p>This gives a present value of CU152,367.^(b)</p>
<p>[paragraph AG4(c)]</p> <p>The difference between the observed market price of the liability at the end of the period and the amount determined in accordance with paragraph AG4(b) is the change in fair value that is not attributable to changes in the observed (benchmark) interest rate. This is the amount to be disclosed.</p>	<p>The market price of the liability at the end of the period is CU153,811.^(c)</p> <p>Thus, the entity discloses CU1,444, which is CU153,811 – CU152,367, as the increase in fair value of the bond that is not attributable to changes in market conditions that give rise to market risk.</p>
<p>(a) $CU150,000 \times 8\% = CU12,000$</p> <p>(b) $PV = [CU12,000 \times (1 - (1 + 0.0775)^{-9})/0.0775] + CU150,000 \times (1 + 0.0775)^{-9}$</p> <p>(c) $\text{market price} = [CU12,000 \times (1 - (1 + 0.076)^{-9})/0.076] + CU150,000 \times (1 + 0.076)^{-9}$</p>	

Defaults and Breaches (paragraphs 22 and 23)

IG12. Paragraphs 22 and 23 require disclosures when there are any defaults or breaches of loans payable. Any defaults or breaches may affect the classification of the liability as current or non-current in accordance with IPSAS 1.

Total Interest Expense (paragraph 24(b))

IG13. Total interest expense disclosed in accordance with paragraph 24(b) is a component of the finance costs, which paragraph 102(b) of IPSAS 1 requires to be presented separately in the statement of financial performance. The line item for finance costs may also include amounts associated with non-financial liabilities.

Fair Value (paragraphs 31–34)

IG14. IPSAS 30 requires disclosures about the level in the fair value hierarchy in which fair value measurements are categorized for assets and liabilities measured in the statement of financial position. A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(a). (Disclosure of comparative information is also required, but is not included in the following example).

Assets Measured at Fair Value		Fair value measurement at end of the reporting period using:		
Description	Dec 31, 20X2	Level 1 CU million	Level 2 CU million	Level 3 CU million
Financial assets at fair value through surplus or deficit				
Trading securities	100	40	55	5
Trading derivatives	39	17	20	2
Available-for-sale financial assets				
Equity investments	75	30	40	5
Total	214	87	115	12

Note: For liabilities, a similar table might be presented.

- IG15. IPSAS 30 requires a reconciliation from beginning to ending balances for those assets and liabilities that are measured in the statement of financial position at fair value based on a valuation technique for which any significant input is not based on observable market data (Level 3). A tabular format is required unless another format is more appropriate. An entity might disclose the following for assets to comply with paragraph 33(b). (Disclosure of comparative information is also required, but is not included in the following example).

Assets Measured at Fair Value Based on Level 3				
	Fair value measurement at the end of the reporting period			
	Financial assets at fair value through surplus or deficit		Available-for-sale financial assets	Total
	Trading securities	Trading derivatives	Equity investments	
	CU million	CU million	CU million	CU million
Opening balance	6	5	4	15
Total gains or losses				
in surplus or deficit	(2)	(2)	-	(4)
in net assets/equity	-	-	(1)	(1)
Purchases	1	2	2	5
Issues	-	-	-	-
Settlements	-	(1)	-	(1)
Transfers out of Level 3	-	(2)	-	(2)
Closing balance	5	2	5	12
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period	(1)	(1)	-	(2)
(Note: For liabilities, a similar table might be presented.)				
Gains or losses included in surplus or deficit for the period (above) are presented in revenue as follows:				
Total gains or losses included in surplus or deficit for the period	Revenue			
	(4)			
Total gains or losses for the period included in surplus or deficit for assets held at the end of the reporting period	(2)			
(Note: For liabilities, a similar table might be presented.)				

- IG16. The fair value at initial recognition of financial instruments that are not traded in active markets is determined in accordance with paragraph AG108 of IPSAS 29. However, when, after initial recognition, an entity will use a valuation technique that incorporates data not obtained from observable markets, there may be a difference between the transaction price at initial recognition and the amount determined at initial recognition using that valuation technique. In these circumstances, the difference will be recognized in surplus or deficit in subsequent periods in accordance with

IPSAS 29 and the entity's accounting policy. Such recognition reflects changes in factors (including time) that market participants would consider in setting a price (see paragraph AG108 of IPSAS 29). Paragraph 33 requires disclosures in these circumstances. An entity might disclose the following to comply with paragraph 34:

Background

On January 1, 20X1 an entity purchases for CU15 million financial assets that are not traded in an active market. The entity has only one class of such financial assets.

The transaction price of CU15 million is the fair value at initial recognition.

After initial recognition, the entity will apply a valuation technique to establish the financial assets' fair value. This valuation technique includes variables other than data from observable markets.

At initial recognition, the same valuation technique would have resulted in an amount of CU14 million, which differs from fair value by CU1 million.

The entity has existing differences of CU5 million at January 1, 20X1.

Application of Requirements

The entity's 20X2 disclosure would include the following:

Accounting Policies

The entity uses the following valuation technique to determine the fair value of financial instruments that are not traded in an active market: [description of technique not included in this example]. Differences may arise between the fair value at initial recognition (which, in accordance with IPSAS 29, is generally the transaction price) and the amount determined at initial recognition using the valuation technique. Any such differences are [description of the entity's accounting policy].

In the Notes to the Financial Statements

As discussed in note X, the entity uses [name of valuation technique] to measure the fair value of the following financial instruments that are not traded in an active market. However, in accordance with IPSAS 29, the fair value of an instrument at inception is generally the transaction price. If the transaction price differs from the amount determined at inception using the valuation technique, that difference is [description of the entity's accounting policy].

The differences yet to be recognized in surplus or deficit are as follows:

	Dec 31, X2 CU million	Dec 31, X1 CU million
Balance at beginning of year	5.3	5.0
New transactions	—	1.0
Amounts recognized in surplus or deficit during the year	(0.7)	(0.8)
Other increases	—	0.2
Other decreases	(0.1)	(0.1)
Balance at end of year	<u>4.5</u>	<u>5.3</u>

Nature and Extent of Risks Arising from Financial Instruments (paragraphs 38–49 and AG6–AG30)

Qualitative Disclosures (paragraph 40)

- IG17. The type of qualitative information an entity might disclose to meet the requirements in paragraph 40 includes, but is not limited to, a narrative description of:
- (a) The entity's exposures to risk and how they arose. Information about risk exposures might describe exposures both gross and net of risk transfer and other risk-mitigating transactions.
 - (b) The entity's policies and processes for accepting, measuring, monitoring, and controlling risk, which might include:
 - (i) The structure and organization of the entity's risk management function(s), including a discussion of independence and accountability;
 - (ii) The scope and nature of the entity's risk reporting or measurement systems;
 - (iii) The entity's policies for hedging or mitigating risk, including its policies and procedures for taking collateral; and
 - (iv) The entity's processes for monitoring the continuing effectiveness of such hedges or mitigating devices.
 - (c) The entity's policies and procedures for avoiding excessive concentrations of risk.
- IG18. Information about the nature and extent of risks arising from financial instruments is more useful if it highlights any relationship between financial instruments that can affect the amount, timing or uncertainty of an entity's future cash flows. The extent to which a risk exposure is altered by such relationships might be apparent to users from the disclosures required by this Standard, but in some cases further disclosures might be useful.
- IG19. In accordance with paragraph 40(c), entities disclose any change in the qualitative information from the previous period and explain the reasons for the change. Such changes may result from changes in exposure to risk or from changes in the way those exposures are managed.

Quantitative Disclosures (paragraphs 41–49 and AG7–AG30)

- IG20. Paragraph 41 requires disclosure of quantitative data about concentrations of risk. For example, concentrations of credit risk may arise from:
- (a) Industry sectors. Thus, if an entity's counterparties are concentrated in one or more industry sectors (such as retail or wholesale), it would

disclose separately exposure to risks arising from each concentration of counterparties.

- (b) Credit rating or other measure of credit quality. Thus, if an entity's counterparties are concentrated in one or more credit qualities (such as secured loans or unsecured loans) or in one or more credit ratings (such as investment grade or speculative grade), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (c) Geographical distribution. Thus, if an entity's counterparties are concentrated in one or more geographical markets (such as Asia or Europe), it would disclose separately exposure to risks arising from each concentration of counterparties.
- (d) A limited number of individual counterparties or groups of closely related counterparties.

Similar principles apply to identifying concentrations of other risks, including liquidity risk and market risk. For example, concentrations of liquidity risk may arise from the repayment terms of financial liabilities, sources of borrowing facilities or reliance on a particular market in which to realize liquid assets. Concentrations of foreign exchange risk may arise if an entity has a significant net open position in a single foreign currency, or aggregate net open positions in several currencies that tend to move together.

- IG21. In accordance with paragraph AG8, disclosure of concentrations of risk includes a description of the shared characteristic that identifies each concentration. For example, the shared characteristic may refer to geographical distribution of counterparties by groups of countries, individual countries or regions within countries.
- IG22. When quantitative information at the end of the reporting period is unrepresentative of the entity's exposure to risk during the period, paragraph 42 requires further disclosure. To meet this requirement, an entity might disclose the highest, lowest, and average amount of risk to which it was exposed during the period. For example, if an entity typically has a large exposure to a particular currency, but at year-end unwinds the position, the entity might disclose a graph that shows the exposure at various times during the period, or disclose the highest, lowest, and average exposures.

Credit Risk (paragraphs 43–45, AG9 and AG10)

- IG23. Paragraph 43 requires an entity to disclose information about its exposure to credit risk by class of financial instrument. Financial instruments in the same class share economic characteristics with respect to the risk being

disclosed (in this case, credit risk). For example, an entity might determine that residential mortgages, unsecured consumer loans, and commercial loans each have different economic characteristics.

Collateral and Other Credit Enhancements Pledged (paragraph 43(b))

IG24. Paragraph 43(b) requires an entity to describe collateral available as security for assets it holds and other credit enhancements obtained. An entity might meet this requirement by disclosing:

- (a) The policies and processes for valuing and managing collateral and other credit enhancements obtained;
- (b) A description of the main types of collateral and other credit enhancements (examples of the latter being guarantees, credit derivatives, and netting agreements that do not qualify for offset in accordance with IPSAS 28);
- (c) The main types of counterparties to collateral and other credit enhancements and their creditworthiness; and
- (d) Information about risk concentrations within the collateral or other credit enhancements.

Credit Quality (paragraph 43(c))

IG25. Paragraph 43(c) requires an entity to disclose information about the credit quality of financial assets with credit risk that are neither past due nor impaired. In doing so, an entity might disclose the following information:

- (a) An analysis of credit exposures using an external or internal credit grading system;
- (b) The nature of the counterparty;
- (c) Historical information about counterparty default rates; and
- (d) Any other information used to assess credit quality.

IG26. When the entity considers external ratings when managing and monitoring credit quality, the entity might disclose information about:

- (a) The amounts of credit exposures for each external credit grade;
- (b) The rating agencies used;
- (c) The amount of an entity's rated and unrated credit exposures; and
- (d) The relationship between internal and external ratings.

IG27. When the entity considers internal credit ratings when managing and monitoring credit quality, the entity might disclose information about:

- (a) The internal credit ratings process;

- (b) The amounts of credit exposures for each internal credit grade; and
- (c) The relationship between internal and external ratings.

Financial Assets that are either Past Due or Impaired (paragraph 44)

- IG28. A financial asset is past due when the counterparty has failed to make a payment when contractually due. As an example, an entity enters into a lending agreement that requires interest to be paid every month. On the first day of the next month, if interest has not been paid, the loan is past due. Past due does not mean that a counterparty will never pay, but it can trigger various actions such as renegotiation, enforcement of covenants, or legal proceedings.
- IG29. When the terms and conditions of financial assets that have been classified as past due are renegotiated, the terms and conditions of the new contractual arrangement apply in determining whether the financial asset remains past due.
- IG30. Paragraph 44(a) requires an analysis by class of the age of financial assets that are past due but not impaired. An entity uses its judgment to determine an appropriate number of time bands. For example, an entity might determine that the following time bands are appropriate:
- (a) Not more than three months;
 - (b) More than three months and not more than six months;
 - (c) More than six months and not more than one year; and
 - (d) More than one year.
- IG31. Paragraph 44(b) requires an analysis of impaired financial assets by class. This analysis might include:
- (a) The carrying amount, before deducting any impairment loss;
 - (b) The amount of any related impairment loss; and
 - (c) The nature and fair value of collateral available and other credit enhancements obtained.

Market Risk (paragraphs 47–49 and AG19–AG30)

- IG32. Paragraph 47(a) requires a sensitivity analysis for each type of market risk to which the entity is exposed. There are three types of market risk: interest rate risk, currency risk, and other price risk. Other price risk may include risks such as equity price risk, commodity price risk, prepayment risk (i.e., the risk that one party to a financial asset will incur a financial loss because the other party repays earlier or later than expected), and residual value risk (e.g., a lessor of motor cars that writes residual value guarantees is exposed

to residual value risk). Risk variables that are relevant to disclosing market risk include, but are not limited to:

- (a) The yield curve of market interest rates. It may be necessary to consider both parallel and non-parallel shifts in the yield curve.
- (b) Foreign exchange rates.
- (c) Prices of equity instruments.
- (d) Market prices of commodities.

IG33. Paragraph 47(a) requires the sensitivity analysis to show the effect on surplus or deficit and net assets/equity of reasonably possible changes in the relevant risk variable. For example, relevant risk variables might include:

- (a) Prevailing market interest rates, for interest-sensitive financial instruments such as a variable rate loan; or
- (b) Currency rates and interest rates, for foreign currency financial instruments such as foreign currency bonds.

IG34. For interest rate risk, the sensitivity analysis might show separately the effect of a change in market interest rates on:

- (a) Interest revenue and expense;
- (b) Other line items of surplus or deficit (such as trading gains and losses); and
- (c) When applicable, net assets/equity.

An entity might disclose a sensitivity analysis for interest rate risk for each currency in which the entity has material exposures to interest rate risk.

IG35. Because the factors affecting market risk vary depending on the specific circumstances of each entity, the appropriate range to be considered in providing a sensitivity analysis of market risk varies for each entity and for each type of market risk.

IG36. The following example illustrates the application of the disclosure requirement in paragraph 47(a):

Interest Rate Risk

At December 31, 20X2, if interest rates at that date had been 10 basis points lower with all other variables held constant, surplus for the year would have been CU1.7 million (20X1—CU2.4 million) higher, arising mainly as a result of lower interest expense on variable borrowings, and other revenue would have been CU2.8 million (20X1—CU3.2 million) higher, arising mainly as a result of an increase in the fair value of fixed rate financial assets classified as available for sale. If interest rates had been 10 basis points higher, with all other variables held constant, surplus would have been CU1.5 million (20X1—CU2.1 million) lower, arising mainly as a result of higher interest expense on variable borrowings, revenue would have been CU3.0 million (20X1—CU3.4 million) lower, arising mainly as a result of a decrease in the fair value of fixed rate financial assets classified as available for sale. Surplus is more sensitive to interest rate decreases than increases because of borrowings with capped interest rates. The sensitivity is lower in 20X2 than in 20X1 because of a reduction in outstanding borrowings that has occurred as the entity's debt has matured (see note X).^(a)

Foreign Currency Exchange Rate Risk

At December 31, 20X2, if the CU had weakened 10 percent against the US dollar with all other variables held constant, surplus for the year would have been CU2.8 million (20X1—CU6.4 million) lower, revenue would have been CU1.2 million (20X1—CU1.1 million) higher. Conversely, if the CU had strengthened 10 percent against the US dollar with all other variables held constant, surplus would have been CU2.8 million (20X1—CU6.4 million) higher, revenue would have been CU1.2 million (20X1—CU1.1 million) lower. The lower foreign currency exchange rate sensitivity in surplus in 20X2 compared with 20X1 is attributable to a reduction in foreign currency denominated debt. Revenue is more sensitive in 20X2 than in 20X1 because of the increased use of hedges of foreign currency purchases, offset by the reduction in foreign currency debt.

(a) Paragraph 46 requires disclosure of a maturity analysis of liabilities.

Other Market Risk Disclosures (paragraph 49)

IG37. Paragraph 49 requires the disclosure of additional information when the sensitivity analysis disclosed is unrepresentative of a risk inherent in a financial instrument. For example, this can occur when:

- (a) A financial instrument contains terms and conditions whose effects are not apparent from the sensitivity analysis (e.g., options that remain out of (or in) the money for the chosen change in the risk variable);
- (b) Financial assets are illiquid (e.g., when there is a low volume of transactions in similar assets and an entity finds it difficult to find a counterparty); or
- (c) An entity has a large holding of a financial asset that, if sold in its entirety, would be sold at a discount or premium to the quoted market price for a smaller holding.

IG38. In the situation in paragraph IG37(a), additional disclosure might include:

- (a) The terms and conditions of the financial instrument (e.g., the options);
- (b) The effect on surplus or deficit if the term or condition were met (i.e., if the options were exercised); and
- (c) A description of how the risk is hedged.

For example, an entity may acquire a zero cost interest rate collar that includes an out-of-the-money leveraged written option (e.g., the entity pays ten times the amount of the difference between a specified interest rate floor and the current market interest rate). The entity may regard the collar as an inexpensive economic hedge against a reasonably possible increase in interest rates. However, an unexpectedly large decrease in interest rates might trigger payments under the written option that, because of the leverage, might be significantly larger than the benefit of lower interest rates. Neither the fair value of the collar nor a sensitivity analysis based on reasonably possible changes in market variables would indicate this exposure. In this case, the entity might provide the additional information described above.

IG39. In the situation described in paragraph IG38(b), additional disclosure might include the reasons for the lack of liquidity and how the entity hedges the risk.

IG40. In the situation described in paragraph IG38(c), additional disclosure might include:

- (a) The nature of the security (e.g., entity name);
- (b) The extent of holding (e.g., 15 percent of the issued shares);
- (c) The effect on surplus or deficit; and
- (d) How the entity hedges the risk.

Comparison with IFRS 7

IPSAS 30, *Financial Instruments: Disclosures* is drawn primarily from IFRS 7, *Financial Instruments: Disclosures* (originally issued in 2005, including amendments published to April 2009). The main differences between IPSAS 30 and IFRS 7 are as follows:

- IPSAS 30 contains requirements related to concessionary loans. IFRS 7 does not require disclosures relating to concessionary loans.
- In certain instances, IPSAS 30 uses different terminology from IFRS 7. The most significant examples are the use of the terms “revenue,” “statement of financial performance,” and “net assets/equity” in IPSAS 30. The equivalent terms in IFRS 7 are “income,” “statement of comprehensive income,” and “equity.”

IPSAS 31—INTANGIBLE ASSETS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 38, *Intangible Assets* published by the International Accounting Standards Board (IASB). It also contains extracts from the Standing Interpretations Committee Interpretation 32 (SIC 32), *Intangible Assets—Web Site Costs*. Extracts from IAS 38 and SIC 32 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IFRSs, IASs, Exposure Drafts, and other publications of the IASB are copyright of the IFRS Foundation.

“IFRS,” “IAS,” “IASB,” “IFRS Foundation,” “International Accounting Standards,” and “International Financial Reporting Standards” are trademarks of the IFRS Foundation and should not be used without the approval of the IFRS Foundation.

IPSAS 31—INTANGIBLE ASSETS

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 15, 2014.

IPSAS 31, *Intangible Assets* was issued in January 2010.

Since then, IPSAS 31 has been amended by the following IPSASs:

- IPSAS 32, *Service Concession Arrangements: Grantor* (issued October 2011)
- *Improvements to IPSASs 2011* (issued October 2011)

Table of Amended Paragraphs in IPSAS 31

Paragraph Affected	How Affected	Affected By
Introduction section	Deleted	Improvements to IPSASs October 2011
6	Amended	IPSAS 32 October 2011
132A	New	IPSAS 32 October 2011

IPSAS 31—INTANGIBLE ASSETS**CONTENTS**

	Paragraph
Objective	1
Scope	2–15
Intangible Heritage Assets	11–15
Definitions	16–25
Intangible Assets	17–20
Control of an Asset	21–24
Future Economic Benefits or Service Potential	25
Recognition and Measurement	26–65
Separate Acquisition	32–39
Subsequent Expenditure on an Acquired In-process Research and Development Project	40–41
Intangible Assets Acquired through Non-Exchange Transactions	42–43
Exchanges of Assets	44–45
Internally Generated Goodwill	46–48
Internally Generated Intangible Assets	49–51
Research Phase	52–54
Development Phase	55–62
Cost of an Internally Generated Intangible Asset	63–65
Recognition of an Expense	66–70
Past Expenses not to be Recognized as an Asset	70
Subsequent Measurement	71–86
Cost Model	73
Revaluation Model	74–86
Useful Life	87–95
Intangible Assets with Finite Useful Lives	96–105
Amortization Period and Amortization Method	96–98

INTANGIBLE ASSETS

Residual Value	99–102
Review of Amortization Period and Amortization Method	103–105
Intangible Assets with Indefinite Useful Lives	106–109
Review of Useful Life Assessment	108–109
Recoverability of the Carrying Amount—Impairment Losses	110
Retirements and Disposals	111–116
Disclosure	117–127
General	117–122
Intangible Assets Measured after Recognition using the Revaluation Model	123–124
Research and Development Expenditure	125–126
Other Information	127
Transition	128–131
Effective Date	132–133
Appendix A: Application Guidance	
Appendix B: Amendments to Other IPSASs	
Basis for Conclusions	
Illustrative Examples	
Comparison with IAS 38	

International Public Sector Accounting Standard 31, *Intangible Assets*, is set out in paragraphs 1–133. All the paragraphs have equal authority. IPSAS 31 should be read in the context of its objective, the Basis for Conclusions, and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting treatment for intangible assets that are not dealt with specifically in another Standard. This Standard requires an entity to recognize an intangible asset if, and only if, specified criteria are met. The Standard also specifies how to measure the carrying amount of intangible assets, and requires specified disclosures about intangible assets.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for intangible assets.**
3. **This Standard shall be applied in accounting for intangible assets, except:**
 - (a) **Intangible assets that are within the scope of another Standard;**
 - (b) **Financial assets, as defined in IPSAS 28, *Financial Instruments: Presentation*;**
 - (c) **The recognition and measurement of exploration and evaluation assets (see the relevant international or national accounting standard dealing with exploration for, and evaluation of, mineral resources);**
 - (d) **Expenditure on the development and extraction of minerals, oil, natural gas and similar non-regenerative resources;**
 - (e) **Intangible assets acquired in a business combination (see the relevant international or national accounting standard dealing with business combinations);**
 - (f) **Goodwill acquired in a business combination (see the relevant international or national accounting standard dealing with business combinations);**
 - (g) **Powers and rights conferred by legislation, a constitution, or by equivalent means;**
 - (h) **Deferred tax assets (see the relevant international or national accounting standard dealing with income taxes);**
 - (i) **Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts. In cases where the relevant international or national accounting standard does not set out specific disclosure requirements for those intangible assets, the**

disclosure requirements in this Standard apply to those intangible assets;

- (j) **Non-current intangible assets classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations; and**
 - (k) **In respect of intangible heritage assets. However, the disclosure requirements of paragraphs 115–127 apply to those heritage assets that are recognized.**
4. **This Standard applies to all public sector entities other than Government Business Enterprises.**
 5. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.
 6. If another IPSAS prescribes the accounting for a specific type of intangible asset, an entity applies that IPSAS instead of this Standard. For example, this Standard does not apply to:
 - (a) Intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11, *Construction Contracts*, and IPSAS 12, *Inventories*);
 - (b) Leases that are within the scope of IPSAS 13, *Leases*;
 - (c) Assets arising from employee benefits (see IPSAS 25, *Employee Benefits*);
 - (d) Financial assets as defined in IPSAS 28. The recognition and measurement of some financial assets are covered by IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates*, and IPSAS 8, *Interests in Joint Ventures*; and
 - (e) Recognition and initial measurement of service concession assets that are within the scope of IPSAS 32, *Service Concession Assets: Grantor*. However, this Standard applies to the subsequent measurement and disclosure of such assets.
 7. Some intangible assets may be contained in or on a physical substance such as a compact disc (in the case of computer software), legal documentation (in the case of a licence or patent), or film. In determining whether an asset that incorporates both intangible and tangible elements should be treated under IPSAS 17, *Property, Plant, and Equipment*, or as an intangible asset under

this Standard, an entity uses judgement to assess which element is more significant. For example, the navigation software for a fighter aircraft is integral to the aircraft and is treated as property, plant and equipment. The same applies to the operating system of a computer. When the software is not an integral part of the related hardware, computer software is treated as an intangible asset.

8. This Standard applies to, among other things, expenditure on advertising, training, start-up, research, and development activities. Research and development activities are directed to the development of knowledge. Therefore, although these activities may result in an asset with physical substance (e.g., a prototype), the physical element of the asset is secondary to its intangible component, i.e., the knowledge embodied in it.
9. In the case of a finance lease, the underlying asset may be either tangible or intangible. After initial recognition, a lessee accounts for an intangible asset held under a finance lease in accordance with this Standard. Rights under licensing agreements for items such as motion picture films, video recordings, plays, manuscripts, patents, and copyrights are excluded from the scope of IPSAS 13 and are within the scope of this Standard.
10. Exclusions from the scope of a Standard may occur if activities or transactions are so specialized that they give rise to accounting issues that may need to be dealt with in a different way. Such issues arise in the accounting for expenditure on the exploration for, or development and extraction of, oil, gas, and mineral deposits in extractive industries, and in the case of insurance contracts. Therefore, this Standard does not apply to expenditure on such activities and contracts. However, this Standard applies to other intangible assets used (such as computer software), and other expenditure incurred (such as start-up costs), in extractive industries, or by insurers.

Intangible Heritage Assets

11. This Standard does not require an entity to recognize intangible heritage assets that would otherwise meet the definition of, and recognition criteria for, intangible assets. If an entity does recognize intangible heritage assets, it must apply the disclosure requirements of this Standard and may, but is not required to, apply the measurement requirements of this Standard.
12. Some intangible assets are described as intangible heritage assets because of their cultural, environmental, or historical significance. Examples of intangible heritage assets include recordings of significant historical events and rights to use the likeness of a significant public person on, for example, postage stamps or collectible coins. Certain characteristics, including the following, are often displayed by intangible heritage assets (although these characteristics are not exclusive to such assets):

- (a) Their value in cultural, environmental, and historical terms is unlikely to be fully reflected in a financial value based purely on a market price;
 - (b) Legal and/or statutory obligations may impose prohibitions or severe restrictions on disposal by sale;
 - (c) Their value may increase over time; and
 - (d) It may be difficult to estimate their useful lives, which in some cases could be several hundred years.
13. Public sector entities may have large holdings of intangible heritage assets that have been acquired over many years and by various means, including purchase, donation, bequest, and sequestration. These assets are rarely held for their ability to generate cash inflows, and there may be legal or social obstacles to using them for such purposes.
14. Some intangible heritage assets have future economic benefits or service potential other than their heritage value, for example, royalties paid to the entity for use of an historical recording. In these cases, an intangible heritage asset may be recognized and measured on the same basis as other items of cash-generating intangible assets. For other intangible heritage assets, their future economic benefit or service potential is limited to their heritage characteristics. The existence of both future economic benefits and service potential can affect the choice of measurement base.
15. The disclosure requirements in paragraphs 117–124 require entities to make disclosures about recognized intangible assets. Therefore, entities that recognize intangible heritage assets are required to disclose in respect of those assets such matters as, for example:
- (a) The measurement basis used;
 - (b) The amortization method used, if any;
 - (c) The gross carrying amount;
 - (d) The accumulated amortization at the end of the period, if any; and
 - (e) A reconciliation of the carrying amount at the beginning and end of the period showing certain components thereof.

Definitions

16. **The following terms are used in this Standard with the meanings specified:**
- Amortization** is the systematic allocation of the depreciable amount of an intangible asset over its useful life.

Carrying amount is the amount at which an asset is recognized after deducting any accumulated amortization and accumulated impairment losses.

Development is the application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.

An **intangible asset** is an identifiable non-monetary asset without physical substance.

Research is original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.

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

Intangible Assets

17. Entities frequently expend resources, or incur liabilities, on the acquisition, development, maintenance, or enhancement of intangible resources such as scientific or technical knowledge, design and implementation of new processes, or systems, licences, intellectual property, and trademarks (including brand names and publishing titles). Common examples of items encompassed by these broad headings are computer software, patents, copyrights, motion picture films, lists of users of a service, acquired fishing licences, acquired import quotas, and relationships with users of a service.
18. Not all the items described in paragraph 17 meet the definition of an intangible asset, i.e., identifiability, control over a resource, and existence of future economic benefits or service potential. If an item within the scope of this Standard does not meet the definition of an intangible asset, expenditure to acquire it or generate it internally is recognized as an expense when it is incurred.
19. **An asset is identifiable if it either:**
 - (a) **Is separable, i.e., is capable of being separated or divided from the entity and sold, transferred, licensed, rented, or exchanged, either individually or together with a related contract, identifiable asset or liability, regardless of whether the entity intends to do so; or**
 - (b) **Arises from binding arrangements (including rights from contracts or other legal rights), regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.**

20. For the purposes of this Standard, a binding arrangement describes an arrangement that confers similar rights and obligations on the parties to it as if it were in the form of a contract.

Control of an Asset

21. An entity controls an asset if the entity has the power to obtain the future economic benefits or service potential flowing from the underlying resource and to restrict the access of others to those benefits or that service potential. The capacity of an entity to control the future economic benefits or service potential from an intangible asset would normally stem from legal rights that are enforceable in a court of law. In the absence of legal rights, it is more difficult to demonstrate control. However, legal enforceability of a right is not a necessary condition for control because an entity may be able to control the future economic benefits or service potential in some other way.
22. Scientific or technical knowledge may give rise to future economic benefits or service potential. An entity controls those benefits or that service potential if, for example, the knowledge is protected by legal rights such as copyrights, a restraint of trade agreement (where permitted), or by a legal duty on employees to maintain confidentiality.
23. An entity may have a team of skilled staff and may be able to identify incremental staff skills leading to future economic benefits or service potential from training. The entity may also expect that the staff will continue to make their skills available to the entity. However, an entity usually has insufficient control over the expected future economic benefits or service potential arising from a team of skilled staff and from training for these items to meet the definition of an intangible asset. For a similar reason, specific management or technical talent is unlikely to meet the definition of an intangible asset, unless it is protected by legal rights to use it and to obtain the future economic benefits or service potential expected from it, and it also meets the other parts of the definition.
24. An entity may have a portfolio of users of its services or its success rate in reaching intended users of its services and expect that, because of its efforts in building relationships with users of its services, those users will continue to use its services. However, in the absence of legal rights to protect, or other ways to control the relationships with users of a service or the loyalty of those users, the entity usually has insufficient control over the expected economic benefits or service potential from relationships with users of a service and loyalty for such items (e.g., portfolio of users of a service, market shares or success rates of a service, relationships with, and loyalty of, users of a service) to meet the definition of intangible assets. In the absence of legal rights to protect such relationships, exchange transactions for the same or similar non-contractual customer relationships provide evidence that the entity is nonetheless able to control the expected future economic benefits or service

potential flowing from the relationships with the users of a service. Because such exchange transactions also provide evidence that the relationships with users of a service are separable, those relationships meet the definition of an intangible asset.

Future Economic Benefits or Service Potential

25. The future economic benefits or service potential flowing from an intangible asset may include revenue from the sale of products or services, cost savings, or other benefits resulting from the use of the asset by the entity. For example, the use of intellectual property in a production or service process may reduce future production or service costs or improve service delivery rather than increase future revenues (e.g., an on-line system that allows citizens to renew driving licences more quickly on-line, resulting in a reduction in office staff required to perform this function while increasing the speed of processing).

Recognition and Measurement

26. The recognition of an item as an intangible asset requires an entity to demonstrate that the item meets:
 - (a) The definition of an intangible asset (see paragraphs 17–25); and
 - (b) The recognition criteria (see paragraphs 28–30).

This requirement applies to the cost measured at recognition (the cost in an exchange transaction or to internally generate an intangible asset, or the fair value of an intangible asset acquired through a non-exchange transaction) and those incurred subsequently to add to, replace part of, or service it.

27. The nature of intangible assets is such that, in many cases, there are no additions to such an asset or replacements of part of it. Accordingly, most subsequent expenditures are likely to maintain the expected future economic benefits or service potential embodied in an existing intangible asset rather than meet the definition of an intangible asset and the recognition criteria in this Standard. In addition, it is often difficult to attribute subsequent expenditure directly to a particular intangible asset rather than to the entity's operations as a whole. Therefore, only rarely will subsequent expenditure—expenditure incurred after the initial recognition of an acquired intangible asset or after completion of an internally generated intangible asset—be recognized in the carrying amount of an asset. Consistent with paragraph 61, subsequent expenditure on brands, mastheads, publishing titles, lists users of a service, and items similar in substance (whether externally acquired or internally generated) is always recognized in surplus or deficit as incurred. This is because such expenditure cannot be distinguished from expenditure to develop the entity's operations as a whole.
28. **An intangible asset shall be recognized if, and only if:**

- (a) **It is probable that the expected future economic benefits or service potential that are attributable to the asset will flow to the entity; and**
 - (b) **The cost or fair value of the asset can be measured reliably.**
29. **An entity shall assess the probability of expected future economic benefits or service potential using reasonable and supportable assumptions that represent management's best estimate of the set of economic conditions that will exist over the useful life of the asset.**
30. An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits or service potential that are attributable to the use of the asset on the basis of the evidence available at the time of initial recognition, giving greater weight to external evidence.
31. **An intangible asset shall be measured initially at cost in accordance with paragraphs 32–43. Where an intangible asset is acquired through a non-exchange transaction, its initial cost at the date of acquisition, shall be measured at its fair value as at that date.**

Separate Acquisition

32. Normally, the price an entity pays to acquire separately an intangible asset will reflect expectations about the probability that the expected future economic benefits or service potential embodied in the asset will flow to the entity. In other words, the entity expects there to be an inflow of economic benefits or service potential, even if there is uncertainty about the timing or the amount of the inflow. Therefore, the probability recognition criterion in paragraph 28(a) is always considered to be satisfied for separately acquired intangible assets.
33. In addition, the cost of a separately acquired intangible asset can usually be measured reliably. This is particularly so when the purchase consideration is in the form of cash or other monetary assets.
34. The cost of a separately acquired intangible asset comprises:
- (a) Its purchase price, including import duties and non-refundable purchase taxes, after deducting trade discounts and rebates; and
 - (b) Any directly attributable cost of preparing the asset for its intended use.
35. Examples of directly attributable costs are:
- (a) Costs of employee benefits (as defined in IPSAS 25) arising directly from bringing the asset to its working condition;
 - (b) Professional fees arising directly from bringing the asset to its working condition; and

- (c) Costs of testing whether the asset is functioning properly.
- 36. Examples of expenditures that are not part of the cost of an intangible asset are:
 - (a) Costs of introducing a new product or service (including costs of advertising and promotional activities);
 - (b) Costs of conducting operations in a new location or with a new class of users of a service (including costs of staff training); and
 - (c) Administration and other general overhead costs.
- 37. Recognition of costs in the carrying amount of an intangible asset ceases when the asset is in the condition necessary for it to be capable of operating in the manner intended by management. Therefore, costs incurred in using or redeploying an intangible asset are not included in the carrying amount of that asset. For example, the following costs are not included in the carrying amount of an intangible asset:
 - (a) Costs incurred while an asset capable of operating in the manner intended by management has yet to be brought into use; and
 - (b) Initial operating deficits, such as those incurred while demand for the asset's output builds up.
- 38. Some operations occur in connection with the development of an intangible asset, but are not necessary to bring the asset to the 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 condition necessary for it to be capable of operating in the manner intended by management, the revenue and related expenses of incidental operations are recognized immediately in surplus or deficit, and included in their respective classifications of revenue and expense.
- 39. If payment for an intangible asset is deferred beyond normal credit terms, its cost is the cash price equivalent. The difference between this amount and the total payments is recognized as interest expense over the period of credit unless it is capitalized in accordance with the capitalization treatment permitted in IPSAS 5, *Borrowing Costs*.

Subsequent Expenditure on an Acquired In-process Research and Development Project

- 40. **Research or development expenditure that:**
 - (a) **Relates to an in-process research or development project acquired separately and recognized as an intangible asset; and**
 - (b) **Is incurred after the acquisition of that project;**

shall be accounted for in accordance with paragraphs 52–60.

41. Applying the requirements in paragraphs 52–60 means that subsequent expenditure on an in-process research or development project acquired separately and recognized as an intangible asset is:
 - (a) Recognized as an expense when incurred if it is research expenditure;
 - (b) Recognized as an expense when incurred if it is development expenditure that does not satisfy the criteria for recognition as an intangible asset in paragraph 55; and
 - (c) Added to the carrying amount of the acquired in-process research or development project if it is development expenditure that satisfies the recognition criteria in paragraph 55.

Intangible Assets Acquired through Non-Exchange Transactions

42. In some cases, an intangible asset may be acquired through a non-exchange transaction. This may happen when another public sector entity transfers to an entity in a non-exchange transaction, intangible assets such as airport landing rights, licences to operate radio or television stations, import licences or quotas or rights to access other restricted resources. A private citizen, for example a Nobel Prize winner, may bequeath his or her personal papers, including the copyright to his or her publications to the national archives (a public sector entity) in a non-exchange transaction.
43. Under these circumstances the cost of the item is its fair value at the date it is acquired. For the purposes of this Standard, the measurement at recognition of an intangible asset acquired through a non-exchange transaction, at its fair value consistent with the requirements of paragraph 74, does not constitute a revaluation. Accordingly, the revaluation requirements in paragraph 74, and the supporting commentary in paragraphs 75–86 only apply when an entity elects to revalue an intangible item in subsequent reporting periods.

Exchanges of Assets

44. One or more intangible assets may be acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets. The following discussion refers simply to an exchange of one non-monetary asset for another, but it also applies to all exchanges described in the preceding sentence. The cost of such an intangible asset is measured at fair value unless the fair value of neither the asset received nor the asset given up is reliably measurable. The acquired asset is measured in this way even if an entity cannot immediately derecognize the asset given up. If the acquired asset is not measured at fair value, its cost is measured at the carrying amount of the asset given up.

45. Paragraph 28(b) specifies that a condition for the recognition of an intangible asset is that the cost of the asset can be measured reliably. The fair value of an intangible asset for which comparable market transactions do not exist is reliably measurable if:

- (a) The variability in the range of reasonable fair value estimates is not significant for that asset; or
- (b) The probabilities of the various estimates within the range can be reasonably assessed and used in estimating fair value.

If an entity is able to determine reliably the fair value of either the asset received or the asset given up, then the fair value of the asset given up is used to measure cost unless the fair value of the asset received is more clearly evident.

Internally Generated Goodwill

46. **Internally generated goodwill shall not be recognized as an asset.**

47. In some cases, expenditure is incurred to generate future economic benefits or service potential, but it does not result in the creation of an intangible asset that meets the recognition criteria in this Standard. Such expenditure is often described as contributing to internally generated goodwill. Internally generated goodwill is not recognized as an asset because it is not an identifiable resource (i.e., it is not separable nor does it arise from binding arrangements (including rights from contracts or other legal rights) controlled by the entity that can be measured reliably at cost.

48. Differences between the market value of an entity and the carrying amount of its identifiable net assets at any time may capture a range of factors that affect the value of the entity. However, such differences do not represent the cost of intangible assets controlled by the entity.

Internally Generated Intangible Assets

49. It is sometimes difficult to assess whether an internally generated intangible asset qualifies for recognition because of problems in:

- (a) Identifying whether and when there is an identifiable asset that will generate expected future economic benefits or service potential; and
- (b) Determining the cost of the asset reliably. In some cases, the cost of generating an intangible asset internally cannot be distinguished from the cost of maintaining or enhancing the entity's internally generated goodwill or of running day-to-day operations.

Therefore, in addition to complying with the general requirements for the recognition and initial measurement of an intangible asset, an entity applies

the requirements and guidance in paragraphs 50–65 to all internally generated intangible assets.

50. To assess whether an internally generated intangible asset meets the criteria for recognition, an entity classifies the generation of the asset into:
 - (a) A research phase; and
 - (b) A development phase.

Although the terms “research” and “development” are defined, the terms “research phase” and “development phase” have a broader meaning for the purpose of this Standard.

51. If an entity cannot distinguish the research phase from the development phase of an internal project to create an intangible asset, the entity treats the expenditure on that project as if it were incurred in the research phase only.

Research Phase

52. **No intangible asset arising from research (or from the research phase of an internal project) shall be recognized. Expenditure on research (or on the research phase of an internal project) shall be recognized as an expense when it is incurred.**
53. In the research phase of an internal project, an entity cannot demonstrate that an intangible asset exists that will generate probable future economic benefits or service potential. Therefore, this expenditure is recognized as an expense when it is incurred.
54. Examples of research activities are:
 - (a) Activities aimed at obtaining new knowledge;
 - (b) The search for, evaluation and final selection of, applications of research findings or other knowledge;
 - (c) The search for alternatives for materials, devices, products, processes, systems, or services; and
 - (d) The formulation, design, evaluation, and final selection of possible alternatives for new or improved materials, devices, products, processes, systems, or services.

Development Phase

55. **An intangible asset arising from development (or from the development phase of an internal project) shall be recognized if, and only if, an entity can demonstrate all of the following:**
 - (a) **The technical feasibility of completing the intangible asset so that it will be available for use or sale;**

- (b) **Its intention to complete the intangible asset and use or sell it;**
 - (c) **Its ability to use or sell the intangible asset;**
 - (d) **How the intangible asset will generate probable future economic benefits or service potential. Among other things, the entity can demonstrate the existence of a market for the output of the intangible asset or the intangible asset itself or, if it is to be used internally, the usefulness of the intangible asset;**
 - (e) **The availability of adequate technical, financial and other resources to complete the development and to use or sell the intangible asset; and**
 - (f) **Its ability to measure reliably the expenditure attributable to the intangible asset during its development.**
56. In the development phase of an internal project, an entity can, in some instances, identify an intangible asset and demonstrate that the asset will generate probable future economic benefits or service potential. This is because the development phase of a project is further advanced than the research phase.
57. Examples of development activities are:
- (a) The design, construction, and testing of pre-production or pre-use prototypes and models;
 - (b) The design of tools, jigs, moulds, and dies involving new technology;
 - (c) The design, construction, and operation of a pilot plant or operation that is not of a scale economically feasible for commercial production or use in providing services;
 - (d) The design, construction, and testing of a chosen alternative for new or improved materials, devices, products, processes, systems, or services; and
 - (e) Website costs and software development costs.
58. To demonstrate how an intangible asset will generate probable future economic benefits or service potential, an entity assesses the future economic benefits or service potential to be received from the asset using the principles in either IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, *Impairment of Cash-Generating Assets*, as appropriate. If the asset will generate economic benefits or service potential only in combination with other assets, the entity applies the concept of cash-generating units in IPSAS 26.
59. Availability of resources to complete, use, and obtain the benefits from an intangible asset can be demonstrated by, for example, an operating plan

showing the technical, financial, and other resources needed and the entity's ability to secure those resources. In some cases, an entity demonstrates the availability of external finance by obtaining a lender's or funder's indication of its willingness to fund the plan.

60. An entity's costing systems can often measure reliably the cost of generating an intangible asset internally, such as salary and other expenditure incurred in securing logos, copyrights or licences, or developing computer software.
61. **Internally generated brands, mastheads, publishing titles, lists of users of a service, and items similar in substance shall not be recognized as intangible assets.**
62. Expenditure on internally generated brands, mastheads, publishing titles, lists of users of a service, and items similar in substance cannot be distinguished from the cost of developing the entity's operations as a whole. Therefore, such items are not recognized as intangible assets.

Cost of an Internally Generated Intangible Asset

63. The cost of an internally generated intangible asset for the purpose of paragraph 31 is the sum of expenditure incurred from the date when the intangible asset first meets the recognition criteria in paragraphs 28, 29, and 55. Paragraph 70 prohibits reinstatement of expenditure previously recognized as an expense.
64. The cost of an internally generated intangible asset comprises all directly attributable costs necessary to create, produce, and prepare the asset to be capable of operating in the manner intended by management. Examples of directly attributable costs are:
 - (a) Costs of materials and services used or consumed in generating the intangible asset;
 - (b) Costs of employee benefits (as defined in IPSAS 25) arising from the generation of the intangible asset;
 - (c) Fees to register a legal right; and
 - (d) Amortization of patents and licences that are used to generate the intangible asset.

IPSAS 5 specifies criteria for the recognition of interest as an element of the cost of an asset that is a qualifying asset.

65. The following are not components of the cost of an internally generated intangible asset:
 - (a) Selling, administrative and other general overhead expenditure unless this expenditure can be directly attributed to preparing the asset for use;

- (b) Identified inefficiencies and initial operating deficits incurred before the asset achieves planned performance; and
- (c) Expenditure on training staff to operate the asset.

Recognition of an Expense

66. **Expenditure on an intangible item shall be recognized as an expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria (see paragraphs 26–65).**
67. In some cases, expenditure is incurred to provide future economic benefits or service potential to an entity, but no intangible asset or other asset is acquired or created that can be recognized. In the case of the supply of goods, the entity recognizes such expenditure as an expense when it has a right to access those goods. In the case of the supply of services, the entity recognizes the expenditure as an expense when it receives the services. For example, expenditure on research is recognized as an expense when it is incurred (see paragraph 52). Other examples of expenditure that is recognized as an expense when it is incurred include:
- (a) Expenditure on start-up activities (i.e., start-up costs), unless this expenditure is included in the cost of an item of property, plant, and equipment in accordance with IPSAS 17. Start-up costs may consist of establishment costs such as legal and secretarial costs incurred in establishing a legal entity, expenditure to open a new facility or operation (i.e., pre-opening costs), or expenditures for starting new operations or launching new products or processes (i.e., pre-operating costs);
 - (b) Expenditure on training activities;
 - (c) Expenditure on advertising and promotional activities (including mail order catalogues and information pamphlets); and
 - (d) Expenditure on relocating or reorganizing part or all of an entity.
68. An entity has a right to access goods when it owns them. Similarly, it has a right to access goods when they have been constructed by a supplier in accordance with the terms of a supply contract and the entity could demand delivery of them in return for payment. Services are received when they are performed by a supplier in accordance with a contract to deliver them to the entity and not when the entity uses them to deliver another service, for example, to deliver information about a service to users of that service.
69. Paragraph 66 does not preclude an entity from recognizing a prepayment as an asset when payment for goods has been made in advance of the entity obtaining a right to access those goods. Similarly, paragraph 66 does not preclude an entity from recognizing a prepayment as an asset when payment for services has been made in advance of the entity receiving those services.

Past Expenses not to be Recognized as an Asset

70. **Expenditure on an intangible item that was initially recognized as an expense under this Standard shall not be recognized as part of the cost of an intangible asset at a later date.**

Subsequent Measurement

71. **An entity shall choose either the cost model in paragraph 73 or the revaluation model in paragraph 74 as its accounting policy. If an intangible asset is accounted for using the revaluation model, all the other assets in its class shall also be accounted for using the same model, unless there is no active market for those assets.**
72. A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. The items within a class of intangible assets are revalued simultaneously to avoid selective revaluation of assets and the reporting of amounts in the financial statements representing a mixture of costs and values as at different dates.

Cost Model

73. **After initial recognition, an intangible asset shall be carried at its cost less any accumulated amortization and any accumulated impairment losses.**

Revaluation Model

74. **After initial recognition, an intangible asset shall be carried at a revalued amount, being its fair value at the date of the revaluation less any subsequent accumulated amortization. For the purpose of revaluations under this Standard, fair value shall be determined by reference to an active market. Revaluations shall be made with such regularity that at the reporting date the carrying amount of the asset does not differ materially from its fair value.**
75. The revaluation model does not allow:
 - (a) The revaluation of intangible assets that have not previously been recognized as assets; or
 - (b) The initial recognition of intangible assets at amounts other than cost.
76. The revaluation model is applied after an asset has been initially recognized at cost. However, if only part of the cost of an intangible asset is recognized as an asset because the asset did not meet the criteria for recognition until part of the way through the process (see paragraph 63), the revaluation model may be applied to the whole of that asset. Also, the revaluation model may be applied to an intangible asset that was received through a non-exchange transaction (see paragraphs 42–43).

77. It is uncommon for an active market to exist for an intangible asset, although this may happen. For example, in some jurisdictions, an active market may exist for freely transferable homogeneous classes of licences or production quotas the entity has acquired from another entity. However, an active market cannot exist for brands, newspaper mastheads, music and film publishing rights, patents, or trademarks, because each such asset is unique. Also, although intangible assets are bought and sold, contracts are negotiated between individual buyers and sellers, and transactions are relatively infrequent. For these reasons, the price paid for one asset may not provide sufficient evidence of the fair value of another. Moreover, prices are often not available to the public.
78. The frequency of revaluations depends on the volatility of the fair values of the intangible assets being revalued. If the fair value of a revalued asset differs materially from its carrying amount, a further revaluation is necessary. Some intangible assets may experience significant and volatile movements in fair value, thus necessitating annual revaluation. Such frequent revaluations are unnecessary for intangible assets with only insignificant movements in fair value.
79. If an intangible asset is revalued, any accumulated amortization 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; or
 - (b) Eliminated against the gross carrying amount of the asset and the net amount restated to the revalued amount of the asset.
80. **If an intangible asset in a class of revalued intangible assets cannot be revalued because there is no active market for this asset, the asset shall be carried at its cost less any accumulated amortization and impairment losses.**
81. **If the fair value of a revalued intangible asset can no longer be determined by reference to an active market, the carrying amount of the asset shall be its revalued amount at the date of the last revaluation by reference to the active market less any subsequent accumulated amortization and any subsequent accumulated impairment losses.**
82. The fact that an active market no longer exists for a revalued intangible asset may indicate that the asset may be impaired and that it needs to be tested in accordance with IPSAS 21 or IPSAS 26, as appropriate.
83. If the fair value of the asset can be determined by reference to an active market at a subsequent measurement date, the revaluation model is applied from that date.

84. **If an intangible asset's carrying amount is increased as a result of a revaluation, the increase shall be credited directly to revaluation surplus. However, the increase shall be recognized in surplus or deficit to the extent that it reverses a revaluation decrease of the same asset previously recognized in surplus or deficit.**
85. **If an intangible asset's carrying amount is decreased as a result of a revaluation, the decrease shall be recognized in surplus or deficit. However, the decrease shall be recognized directly in net assets/equity to the extent of any credit balance in the revaluation surplus in respect of that asset. The decrease recognized directly in net assets/equity reduces the amount accumulated in net assets/equity under the heading of revaluation surplus.**
86. The cumulative revaluation surplus included in net assets/equity may be transferred directly to accumulated surpluses or deficits when the surplus is realized. The whole surplus may be realized on the retirement or disposal of the asset. However, some of the surplus may be realized as the asset is used by the entity; in such a case, the amount of the surplus realized is the difference between amortization based on the revalued carrying amount of the asset and amortization that would have been recognized based on the asset's historical cost. The transfer from revaluation surplus to accumulated surpluses or deficits is not made through surplus or deficit.

Useful Life

87. **An entity shall assess whether the useful life of an intangible asset is finite or indefinite and, if finite, the length of, or number of production or similar units constituting, that useful life. An intangible asset shall be regarded by the entity as having an indefinite useful life when, based on an analysis of all of the relevant factors, there is no foreseeable limit to the period over which the asset is expected to generate net cash inflows for, or provide service potential to, the entity.**
88. The accounting for an intangible asset is based on its useful life. An intangible asset with a finite useful life is amortized (see paragraphs 96–105), and an intangible asset with an indefinite useful life is not (see paragraphs 106–109). The Illustrative Examples accompanying this Standard illustrate the determination of useful life for different intangible assets, and the subsequent accounting for those assets based on the useful life determinations.
89. Many factors are considered in determining the useful life of an intangible asset, including:
 - (a) The expected usage of the asset by the entity and whether the asset could be managed efficiently by another management team;

- (b) Typical product life cycles for the asset and public information on estimates of useful lives of similar 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 or service potential from the asset and the entity's ability and intention 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.
90. The term "indefinite" does not mean "infinite." The useful life of an intangible asset reflects only that level of future maintenance expenditure required to maintain the asset at its standard of performance assessed at the time of estimating the asset's useful life, and the entity's ability and intention to reach such a level. A conclusion that the useful life of an intangible asset is indefinite should not depend on planned future expenditure in excess of that required to maintain the asset at that standard of performance.
91. Given the history of rapid changes in technology, computer software and many other intangible assets are susceptible to technological obsolescence. Therefore, it is likely that their useful life is short.
92. The useful life of an intangible asset may be very long or even indefinite. Uncertainty justifies estimating the useful life of an intangible asset on a prudent basis, but it does not justify choosing a life that is unrealistically short.
93. **The useful life of an intangible asset that arises from binding arrangements (including rights from contracts or other legal rights) shall not exceed the period of the binding arrangement (including rights from contracts or other legal rights), but may be shorter depending on the period over which the entity expects to use the asset. If the binding arrangements (including rights from contracts or other legal rights) are conveyed for a limited term that can be renewed, the useful life of the intangible asset shall include the renewal period(s) only if there is evidence to support renewal by the entity without significant cost.**
94. There may be economic, political, social, and legal factors influencing the useful life of an intangible asset. Economic, political, or social factors determine the period over which future economic benefits or service potential

will be received by the entity. Legal factors may restrict the period over which the entity controls access to such economic benefits or service potential. The useful life is the shorter of the periods determined by these factors.

95. Existence of the following factors, among others, indicates that an entity would be able to renew the binding arrangements (including rights from contracts or other legal rights) without significant cost:
 - (a) There is evidence, possibly based on experience, that the binding arrangements (including rights from contracts or other legal rights) will be renewed. If renewal is contingent upon the consent of a third party, this includes evidence that the third party will give its consent;
 - (b) There is evidence that any conditions necessary to obtain renewal will be satisfied; and
 - (c) The cost to the entity of renewal is not significant when compared with the future economic benefits or service potential expected to flow to the entity from renewal.

If the cost of renewal is significant when compared with the future economic benefits or service potential expected to flow to the entity from renewal, the “renewal” cost represents, in substance, the cost to acquire a new intangible asset at the renewal date.

Intangible Assets with Finite Useful Lives

Amortization Period and Amortization Method

96. **The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life. Amortization shall begin when the asset is available for use, i.e., when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortization shall cease at the earlier of the date that the asset is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations and the date that the asset is derecognized. The amortization method used shall reflect the pattern in which the asset’s future economic benefits or service potential are expected to be consumed by the entity. If that pattern cannot be determined reliably, the straight-line method shall be used. The amortization charge for each period shall be recognized in surplus or deficit unless this or another Standard permits or requires it to be included in the carrying amount of another asset.**
97. A variety of amortization 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 unit

of production method. The method used is selected on the basis of the expected pattern of consumption of the expected future economic benefits or service potential embodied in the asset and is applied consistently from period to period, unless there is a change in the expected pattern of consumption of those future economic benefits or service potential.

98. Amortization is usually recognized in surplus or deficit. However, sometimes the future economic benefits or service potential embodied in an asset are absorbed in producing other assets. In this case, the amortization charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the amortization of intangible assets used in a production process is included in the carrying amount of inventories (see IPSAS 12).

Residual Value

99. **The residual value of an intangible asset with a finite useful life shall be assumed to be zero unless:**
 - (a) **There is a commitment by a third party to acquire the asset at the end of its useful life; or**
 - (b) **There is an active market for the asset, and:**
 - (i) **Residual value can be determined by reference to that market; and**
 - (ii) **It is probable that such a market will exist at the end of the asset's useful life.**
100. The depreciable amount of an asset with a finite useful life is determined after deducting its residual value. A residual value other than zero implies that an entity expects to dispose of the intangible asset before the end of its economic life.
101. An estimate of an asset's residual value is based on the amount recoverable from disposal using prices prevailing at the date of the estimate for the sale of a similar asset that has reached the end of its useful life and has operated under conditions similar to those in which the asset will be used. The residual value is reviewed at least at each reporting date. A change in the asset's residual value is accounted for as a change in an accounting estimate in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
102. The residual value of an intangible asset may increase to an amount equal to or greater than the asset's carrying amount. If it does, the asset's amortization charge is zero unless and until its residual value subsequently decreases to an amount below the asset's carrying amount.

Review of Amortization Period and Amortization Method

103. **The amortization period and the amortization method for an intangible asset with a finite useful life shall be reviewed at least at each reporting date. If the expected useful life of the asset is different from previous estimates, the amortization period shall be changed accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits or service potential embodied in the asset, the amortization method shall be changed to reflect the changed pattern. Such changes shall be accounted for as changes in accounting estimates in accordance with IPSAS 3.**
104. During the life of an intangible asset, it may become apparent that the estimate of its useful life is inappropriate. For example, the recognition of an impairment loss may indicate that the amortization period needs to be changed.
105. Over time, the pattern of future economic benefits or service potential expected to flow to an entity from an intangible asset may change. For example, it may become apparent that a diminishing balance method of amortization is appropriate rather than a straight-line method. Another example is if use of the rights represented by a licence is deferred pending action on other components of the entity's strategic plan. In this case, economic benefits or service potential that flow from the asset may not be received until later periods.

Intangible Assets with Indefinite Useful Lives

106. **An intangible asset with an indefinite useful life shall not be amortized.**
107. In accordance with IPSAS 21 and IPSAS 26, an entity is required to test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment by comparing its recoverable service amount or its recoverable amount, as appropriate, with its carrying amount:
 - (a) Annually; and
 - (b) Whenever there is an indication that the intangible asset may be impaired.

Review of Useful Life Assessment

108. **The useful life of an intangible asset that is not being amortized shall be reviewed each reporting period to determine whether events and circumstances continue to support an indefinite useful life assessment for that asset. If they do not, the change in the useful life assessment from indefinite to finite shall be accounted for as a change in an accounting estimate in accordance with IPSAS 3.**

109. For intangible assets measured under the cost model, reassessing the useful life of an intangible asset as finite rather than indefinite in accordance with either IPSAS 21 or IPSAS 26, as appropriate, is an indicator that the asset may be impaired. As a result, the entity tests the asset for impairment by comparing its recoverable service amount or its recoverable amount, determined in accordance with either IPSAS 21 or IPSAS 26, as appropriate, with its carrying amount, and recognizing any excess of the carrying amount over the recoverable service amount or recoverable amount as appropriate, as an impairment loss.

Recoverability of the Carrying Amount—Impairment Losses

110. To determine whether an intangible asset measured under the cost model is impaired, an entity applies either IPSAS 21 or IPSAS 26, as appropriate. Those Standards explain when and how an entity reviews the carrying amount of its assets, how it determines the recoverable service amount or recoverable amount of an asset, as appropriate, and when it recognizes or reverses an impairment loss.

Retirements and Disposals

111. **An intangible asset shall be derecognized:**
- (a) **On disposal (including disposal through a non-exchange transaction); or**
 - (b) **When no future economic benefits or service potential are expected from its use or disposal.**
112. **The gain or loss arising from the derecognition of an intangible asset shall be determined as the difference between the net disposal proceeds, if any, and the carrying amount of the asset. It shall be recognized in surplus or deficit when the asset is derecognized (unless IPSAS 13 requires otherwise on a sale and leaseback).**
113. The disposal of an intangible asset may occur in a variety of ways (e.g., by sale, by entering into a finance lease, or through a non-exchange transaction). In determining the date of disposal of such an asset, an entity applies the criteria in IPSAS 9, *Revenue from Exchange Transactions* for recognizing revenue from the sale of goods. IPSAS 13 applies to disposal by a sale and leaseback.
114. If, in accordance with the recognition principle in paragraph 28, an entity recognizes in the carrying amount of an asset the cost of a replacement for part of an intangible asset, then it derecognizes the carrying amount of the replaced part. If it is not practicable for an entity to determine the carrying amount of the replaced part, it may use the cost of the replacement as an indication of what the cost of the replaced part was at the time it was acquired or internally generated.

115. The consideration receivable on disposal of an intangible asset is recognized initially at its fair value. If payment for the intangible asset is deferred, the consideration received is recognized initially at the cash price equivalent. The difference between the nominal amount of the consideration and the cash price equivalent is recognized as interest revenue in accordance with IPSAS 9 reflecting the effective yield on the receivable.
116. Amortization of an intangible asset with a finite useful life does not cease when the intangible asset is no longer used, unless the asset has been fully depreciated or is classified as held for sale (or included in a disposal group that is classified as held for sale) in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations.

Disclosure

General

117. **An entity shall disclose the following for each class of intangible assets, distinguishing between internally generated intangible assets and other intangible assets:**
 - (a) **Whether the useful lives are indefinite or finite and, if finite, the useful lives or the amortization rates used;**
 - (b) **The amortization methods used for intangible assets with finite useful lives;**
 - (c) **The gross carrying amount and any accumulated amortization (aggregated with accumulated impairment losses) at the beginning and end of the period;**
 - (d) **The line item(s) of the statement of financial performance in which any amortization of intangible assets is included;**
 - (e) **A reconciliation of the carrying amount at the beginning and end of the period showing:**
 - (i) **Additions, indicating separately those from internal development and those acquired separately;**
 - (ii) **Assets classified as held for sale or included in a disposal group classified as held for sale in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations and other disposals;**
 - (iii) **Increases or decreases during the period resulting from revaluations under paragraphs 74, 84 and 85 (if any);**

- (iv) **Impairment losses recognized in surplus or deficit during the period in accordance with IPSAS 21 or IPSAS 26 (if any);**
- (v) **Impairment losses reversed in surplus or deficit during the period in accordance with IPSAS 21 or IPSAS 26 (if any);**
- (vi) **Any amortization recognized during the period;**
- (vii) **Net exchange differences arising on the translation of the financial statements into the presentation currency, and on the translation of a foreign operation into the presentation currency of the entity; and**
- (viii) **Other changes in the carrying amount during the period.**

118. A class of intangible assets is a grouping of assets of a similar nature and use in an entity's operations. Examples of separate classes may include:

- (a) Brand names;
- (b) Mastheads and publishing titles;
- (c) Computer software;
- (d) Licences;
- (e) Copyrights, patents, and other industrial property rights, service, and operating rights;
- (f) Recipes, formulae, models, designs, and prototypes; and
- (g) Intangible assets under development.

The classes mentioned above are disaggregated (aggregated) into smaller (larger) classes if this results in more relevant information for the users of the financial statements.

119. An entity discloses information on impaired intangible assets in accordance with IPSAS 21 or IPSAS 26 in addition to the information required by paragraph 117(e)(iii)–(v).

120. IPSAS 3 requires an entity to disclose the nature and amount of a change in an accounting estimate that has a material effect in the current period or is expected to have a material effect in subsequent periods. Such disclosure may arise from changes in:

- (a) The assessment of an intangible asset's useful life;
- (b) The amortization method; or
- (c) Residual values.

121. An entity shall also disclose:

- (a) **For an intangible asset assessed as having an indefinite useful life, the carrying amount of that asset and the reasons supporting the assessment of an indefinite useful life. In giving these reasons, the entity shall describe the factor(s) that played a significant role in determining that the asset has an indefinite useful life.**
- (b) **A description, the carrying amount, and remaining amortization period of any individual intangible asset that is material to the entity's financial statements.**
- (c) **For intangible assets acquired through a non-exchange transaction and initially recognized at fair value (see paragraphs 42–43):**
 - (i) **The fair value initially recognized for these assets;**
 - (ii) **Their carrying amount; and**
 - (iii) **Whether they are measured after recognition under the cost model or the revaluation model.**
- (d) **The existence and carrying amounts of intangible assets whose title is restricted and the carrying amounts of intangible assets pledged as security for liabilities.**
- (e) **The amount of contractual commitments for the acquisition of intangible assets.**

122. When an entity describes the factor(s) that played a significant role in determining that the useful life of an intangible asset is indefinite, the entity considers the list of factors in paragraph 89.

Intangible Assets Measured after Recognition using the Revaluation Model

123. If intangible assets are accounted for at revalued amounts, an entity shall disclose the following:

- (a) **By class of intangible assets:**
 - (i) **The effective date of the revaluation;**
 - (ii) **The carrying amount of revalued intangible assets; and**
 - (iii) **The carrying amount that would have been recognized had the revalued class of intangible assets been measured after recognition using the cost model in paragraph 73;**
- (b) **The amount of the revaluation surplus that relates to intangible assets at the beginning and end of the reporting period, indicating the changes during the reporting period and any restrictions on the distribution of the balance to owners; and**

- (c) **The methods and significant assumptions applied in estimating the assets' fair values.**

124. It may be necessary to aggregate the classes of revalued assets into larger classes for disclosure purposes. However, classes are not aggregated if this would result in the combination of a class of intangible assets that includes amounts measured under both the cost and revaluation models.

Research and Development Expenditure

- 125. **An entity shall disclose the aggregate amount of research and development expenditure recognized as an expense during the period.**
- 126. Research and development expenditure comprises all expenditure that is directly attributable to research or development activities (see paragraphs 64 and 65 for guidance on the type of expenditure to be included for the purpose of the disclosure requirement in paragraph 125).

Other Information

- 127. An entity is encouraged, but not required, to disclose the following information:
 - (a) A description of any fully amortized intangible asset that is still in use; and
 - (b) A brief description of significant intangible assets controlled by the entity but not recognized as assets because they did not meet the recognition criteria in this Standard.

Transition

- 128. **An entity that has previously recognized intangible assets shall apply this Standard retrospectively in accordance with IPSAS 3.**
- 129. **An entity that has not previously recognized intangible assets and uses the accrual basis of accounting shall apply this Standard prospectively. However, retrospective application is permitted.**
- 130. For intangible items that meet:
 - (a) The recognition criteria in this Standard (including reliable measurement of original cost); and
 - (b) The criteria in this Standard for revaluation (including existence of an active market);

an entity may elect to measure an intangible asset on the date of transition, at its fair value and use that fair value as its deemed cost at that date.

131. An entity may elect to use a previous revaluation of an intangible asset at, or before, the date of transition as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to:
 - (a) Fair value; or
 - (b) Cost or depreciated cost in accordance with IPSASs, adjusted to reflect, for example, changes in a general or specific price index.

Effective Date

132. **An entity shall apply this Standard for annual financial statements covering periods beginning on or after April 1, 2011. Earlier application is encouraged. If an entity applies this Standard for a period beginning before April 1, 2011, it shall disclose that fact and apply IPSAS 21 and IPSAS 26 at the same time.**
- 132A. **Paragraph 6 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 5, 7 and 107C of IPSAS 17 and the amendments to paragraphs 2 and 125A of IPSAS 29.**
133. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 31.

Website Costs

- AG1. An entity may incur internal expenditure on the development and operation of its own website for internal or external access. A website designed for external access may be used for various purposes such as to disseminate information, create awareness of services, request comment on draft legislation, promote and advertise an entity's own services and products, provide electronic services, and sell services and products. A website designed for internal access may be used to store entity policies and details of users of a service, and search relevant information.
- AG2. The stages of a website's development can be described as follows:
- (a) Planning—including undertaking feasibility studies, defining objectives and specifications, evaluating alternatives, and selecting preferences;
 - (b) Application and Infrastructure Development—including obtaining a domain name, purchasing and developing hardware and operating software, installing developed applications, and stress testing;
 - (c) Graphical Design Development—including designing the appearance of web pages; and
 - (d) Content Development—including creating, purchasing, preparing, and uploading information, either textual or graphical in nature, on the website before the completion of the website's development. This information may either be stored in separate databases that are integrated into (or accessed from) the website or coded directly into the web pages.
- AG3. Once development of a website has been completed, the Operating stage begins. During this stage, an entity maintains and enhances the applications, infrastructure, graphical design, and content of the website.
- AG4. When accounting for internal expenditure on the development and operation of an entity's own website for internal or external access, the issues are:
- (a) Whether the website is an internally generated intangible asset that is subject to the requirements of this Standard; and
 - (b) The appropriate accounting treatment of such expenditure.

- AG5. This Application Guidance does not apply to expenditure on purchasing, developing, and operating hardware (e.g., web servers, staging servers, production servers, and Internet connections) of a website. Such expenditure is accounted for under IPSAS 17. Additionally, when an entity incurs expenditure on an Internet service provider hosting the entity's website, the expenditure is recognized as an expense when the services are received.
- AG6. IPSAS 31 does not apply to intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11 and IPSAS 12) or leases that fall within the scope of IPSAS 13. Accordingly, this Application Guidance does not apply to expenditure on the development or operation of a website (or website software) for sale to another entity. When a website is leased under an operating lease, the lessor applies this Application Guidance. When a website is leased under a finance lease, the lessee applies this Application Guidance after initial recognition of the leased asset.
- AG7. An entity's own website that arises from development and is for internal or external access is an internally generated intangible asset that is subject to the requirements of this Standard.
- AG8. A website arising from development is recognized as an intangible asset if, and only if, in addition to complying with the general requirements described in paragraph 28 of this Standard for recognition and initial measurement, an entity can satisfy the requirements in paragraph 55 of this Standard. In particular, an entity may be able to satisfy the requirement to demonstrate how its website will generate probable future economic benefits or service potential in accordance with paragraph 55(d) of this Standard when, for example, the website is capable of generating revenues, including direct revenues from enabling orders to be placed, or providing services using the website, rather than at a physical location using civil servants. An entity is not able to demonstrate how a website developed solely or primarily for promoting and advertising its own services and products will generate probable future economic benefits or service potential, and consequently all expenditure on developing such a website is recognized as an expense when incurred.
- AG9. Any internal expenditure on the development and operation of an entity's own website is accounted for in accordance with this Standard. The nature of each activity for which expenditure is incurred (e.g., training employees and maintaining the website) and the website's stage of development or post-development are evaluated to determine the appropriate accounting treatment (additional guidance is provided in the table included at the end of the Illustrative Examples). For example:

- (a) The Planning stage is similar in nature to the research phase in paragraphs 52–54 of this Standard. Expenditure incurred in this stage is recognized as an expense when it is incurred;
- (b) The Application and Infrastructure Development stage, the Graphical Design stage, and the Content Development stage, to the extent that content is developed for purposes other than to advertise and promote an entity's own services and products, are similar in nature to the development phase in paragraphs 55–62 of this Standard. Expenditure incurred in these stages is included in the cost of a website recognized as an intangible asset in accordance with paragraph AG8 when the expenditure can be directly attributed and is necessary to creating, producing or preparing the website for it to be capable of operating in the manner intended by management. For example, expenditure on purchasing or creating content (other than content that advertises and promotes an entity's own services and products) specifically for a website, or expenditure to enable use of the content (e.g., a fee for acquiring a license to reproduce) on the website, is included in the cost of development when this condition is met. However, in accordance with paragraph 83 of this Standard, expenditure on an intangible item that was initially recognized as an expense in previous financial statements is not recognized as part of the cost of an intangible asset at a later date (e.g., if the costs of a copyright have been fully amortized, and the content is subsequently provided on a website);
- (c) Expenditure incurred in the Content Development stage, to the extent that content is developed to advertise and promote an entity's own services and products (e.g., digital photographs of products), is recognized as an expense when incurred in accordance with paragraph 67(c) of this Standard. For example, when accounting for expenditure on professional services for taking digital photographs of an entity's own products and for enhancing their display, expenditure is recognized as an expense as the professional services are received during the process, not when the digital photographs are displayed on the website; and
- (d) The Operating stage begins once development of a website is complete. Expenditure incurred in this stage is recognized as an expense when it is incurred unless it meets the recognition criteria in paragraph 28 of this Standard.

AG10. A website that is recognized as an intangible asset under paragraph AG8 of this Application Guidance is measured after initial recognition by applying the requirements of paragraphs 71–86 of this Standard. The best estimate of a website's useful life should be short, as described in paragraph 91.

- AG11. The guidance in paragraphs AG1–AG10 does not specifically apply to software development costs. However, an entity may apply the principles in these paragraphs.

Appendix B

Amendments to Other IPSASs

IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*

Paragraph 22 is amended as follows:

22. The initial application of a policy to revalue assets in accordance with IPSAS 17, *Property, Plant, and Equipment* or ~~the relevant international or national accounting standard dealing with intangible assets~~ IPSAS 31, *Intangible Assets* is a change in accounting policy to be dealt with as a revaluation in accordance with IPSAS 17 or ~~that relevant Standard~~ IPSAS 31, rather than in accordance with this Standard.

IPSAS 13, *Leases*

Paragraph 36 is amended as follows:

36. A finance lease gives rise to a depreciation expense for depreciable assets as well as finance expense for each accounting period. The depreciation policy for depreciable leased assets shall be consistent with that for depreciable assets that are owned, and the depreciation recognised shall be calculated in accordance with International Public Sector Accounting Standard (IPSAS 17), *Property, Plant, and Equipment* or ~~any international and/or national accounting standard on intangible assets which has been adopted by the entity~~ IPSAS 31, *Intangible Assets*, as appropriate. If there is no reasonable certainty that the lessee will obtain ownership by the end of the lease term, the asset shall be fully depreciated over the shorter of the lease term and its useful life.

Paragraph 41 is amended as follows:

41. In addition, the requirements for disclosure in accordance with IPSAS 16, IPSAS 17, IPSAS 21, and ~~any international and/or national accounting standard on intangible assets~~ IPSAS 31 and on impairment of cash-generating assets which have been adopted by the entity are applied to the amounts of leased assets under finance leases that are accounted for by the lessee as acquisition of assets.

Paragraph 66 is amended as follows:

66. The depreciation policy for depreciable leased assets shall be consistent with the lessor's normal depreciation policy for similar assets, and depreciation shall be calculated in accordance with IPSAS 17 or IPSAS 31, as appropriate, and ~~any international and/or national accounting standard on intangible assets that has been adopted by the entity~~.

IPSAS 17, *Property, Plant, and Equipment*

Paragraph 65 is amended as follows:

65. The depreciation charge for a period is usually recognized in surplus or deficit. However, sometimes, the future economic benefits or service potential embodied in an asset is absorbed in producing other assets. In this case, the depreciation charge constitutes part of the cost of the other asset and is included in its carrying amount. For example, the depreciation of manufacturing plant and equipment is included in the costs of conversion of inventories (see IPSAS 12). Similarly, depreciation of property, plant and equipment used for development activities may be included in the cost of an intangible asset recognized in accordance with ~~the relevant international or national accounting standard dealing with intangible assets~~ IPSAS 31, *Intangible Assets*.

IPSAS 21, *Impairment of Non-Cash Generating Assets*

Paragraph 2 is amended as follows:

Scope

2. An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for impairment of non cash-generating assets, except:
- (a) Inventories (see IPSAS 12, *Inventories*);
 - (b) Assets arising from construction contracts (see IPSAS 11, *Construction Contracts*);
 - (c) Financial assets that are included in the scope of IPSAS 15, *Financial Instruments: Disclosure and Presentation*;
 - (d) Investment property that is measured using the fair value model (see IPSAS 16, *Investment Property*);
 - (e) Non-cash-generating property, plant and equipment that is measured at revalued amounts (see IPSAS 17, *Property, Plant, and Equipment*);
 - (f) Non-cash-generating intangible assets that are measured at revalued amounts (see IPSAS 31, *Intangible Assets*); and
 - (f) Other assets in respect of which accounting requirements for impairment are included in another International Public Sector Accounting Standard.

Paragraph 7 is amended as follows:

7. This Standard excludes non-cash-generating intangible assets that are regularly revalued to fair value from its scope. This Standard includes all other non-cash-generating intangible assets (e.g., those that are carried at cost less any accumulated amortization) within its scope. Entities apply the requirements of this Standard to recognizing and measuring impairment losses, and reversals of impairment losses, related to such non-cash-generating intangible assets.

Additional paragraphs are inserted after paragraph 26 as follows:

- 26A. Irrespective of whether there is any indication of impairment, an entity shall also test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable service amount. This impairment test may be performed at any time during the reporting period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognized during the current reporting period, that intangible asset shall be tested for impairment before the end of the current reporting period.
- 26B. The ability of an intangible asset to generate sufficient future economic benefits or service potential to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

An additional heading and a new paragraph are inserted after paragraph 39 as follows:

Measuring the Recoverable Service Amount of an Intangible Asset with an Indefinite Useful Life

- 39A. Paragraph 26A requires an intangible asset with an indefinite useful life to be tested for impairment annually by comparing its carrying amount with its recoverable service amount, irrespective of whether there is any indication that it may be impaired. However, the most recent detailed calculation of such an asset's recoverable service amount made in a preceding period may be used in the impairment test for that asset in the current period, provided all of the following criteria are met:
- (a) If the intangible asset does not provide service potential from continuing use that is largely independent of those from other assets or groups of assets and is therefore tested for impairment as part of the cash-generating unit to which it belongs, the assets and liabilities

making up that unit have not changed significantly since the most recent recoverable amount calculation:

- (b) The most recent recoverable service amount calculation resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and
- (c) Based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable service amount calculation, the likelihood that a current recoverable service amount determination would be less than the asset's carrying amount is remote.

A new paragraph is inserted after paragraph 82 as follows:

82A. IPSAS 31 amended paragraph 7 and inserted paragraphs 26A, 26B, and 39A. An entity shall apply those amendments for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies IPSAS 31 for a period beginning before April 1, 2011, the amendments shall also be applied for that earlier period.

Paragraph BC14 is amended:

BC14. ~~IAS 36~~ IPSAS 21 contains specific requirements for testing intangible assets for impairment, and for recognizing and measuring impairment losses related to intangible assets. These requirements complement the requirements of ~~IAS 38~~IPSAS 31, *Intangible Assets*. ~~The IPSASB has not issued an IPSAS on intangible assets, so has not considered the applicability of the IAS 36 impairment requirements to non-cash-generating intangible assets in the public sector. Non-cash-generating intangible assets measured at cost are not excluded from~~ included in the scope of this Standard. ~~Therefore this Standard applies to those assets. Public sector intangible assets measured at cost such as those reflecting the entity's ability to issue licenses may arise in a cash-generating context. Other intangible assets may arise in a non-cash-generating context and should be tested for impairment according to the requirements of this Standard.~~

Paragraphs BC17–BC19 are amended as follows:

Property, Plant, and Equipment and Intangible Assets

BC17. The Standard does not require the application of an impairment test to non-cash-generating assets that are carried at revalued amounts under the allowed alternative treatment ("revaluation model") in IPSAS 17 and IPSAS 31. The IPSASB is of the view that under the allowed alternative treatment in IPSAS 17 and IPSAS 31, assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value as at the reporting date and any impairment will be taken into account in the valuation. Therefore any difference

between the asset's carrying amount and its fair value less costs to sell will be the disposal costs. The IPSASB is of the view that, in most cases, these will not be material and, from a practical viewpoint, it is not necessary to measure an asset's recoverable service amount and to recognize an impairment loss for the disposal costs of a non-cash-generating asset.

BC18. In contrast to this Standard, IAS 36 requires entities to test revalued ~~property, plant and equipment~~ assets for impairment after they had been revalued. The rationale for this difference can be explained by reference to the factors set out in paragraphs BC19 and BC20 below.

BC19. Firstly, there are different methods of determining recoverable service amount under this Standard and of determining recoverable amount under IAS 36. Recoverable service amount is defined in this Standard as the higher of a non-cash-generating asset's fair value less costs to sell and its value in use. Under this Standard, an entity determines an asset's value in use by determining the current cost to replace the asset's remaining service potential. The current cost to replace the asset's remaining service potential is determined using any of the depreciated replacement cost approach, approaches described as the restoration cost approach, and the service units approach. These approaches may also be adopted to measure fair value under IPSAS 17 and IPSAS 31 therefore the value in use is a measure of fair value. Recoverable amount is defined in IAS 36 as the higher of an asset's fair value less costs to sell and its value in use. Value in use under IAS 36 is determined using the present value of the cash flows expected to be derived from continued use of the asset and its eventual disposal. IAS 36 states that the value in use may be different from the fair value of the asset.

IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*

Paragraph IG27 is amended as follows:

IG27. This is an exchange transaction. In return for the grant, the university provides research services and an intangible asset, the right (a future economic benefit) to profit from the research results. IPSAS 9 and ~~the relevant international or national accounting standard dealing with intangible assets~~ IPSAS 31, *Intangible Assets* apply to this transaction.

IPSAS 26, *Impairment of Cash-Generating Assets*

Paragraph 2(h) is amended as follows:

2. ...

- (h) Cash-generating ~~intangible~~ assets that are ~~regularly~~ measured at revalued ~~to fair value~~ amounts (see IPSAS 31, *Intangible Assets*);

A new paragraph is inserted after paragraph 126B as follows:

126C. IPSAS 31 amended paragraph 2(h). An entity shall apply that amendment for annual financial statements covering periods beginning on or after April 1, 2011. If an entity applies IPSAS 31 for a period beginning before April 1, 2011, the amendment shall also be applied for that earlier period.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 31.

Background

- BC1. The IPSASB's IFRSs Convergence Program is an important element in IPSASB's work program. The IPSASB's policy is to converge accrual basis IPSASs with IFRSs issued by the IASB where appropriate for public sector entities.
- BC2. Accrual basis IPSASs that are converged with IFRSs maintain the requirements, structure and text of the IFRSs, unless there is a public sector specific reason for a departure. Departure from the equivalent IFRS occurs when requirements or terminology in the IFRS are not appropriate for the public sector, or when inclusion of additional commentary or examples is necessary to illustrate certain requirements in the public sector context. Differences between IPSASs and their equivalent IFRSs are identified in the *Comparison with IFRS* included in each IPSAS. The Comparison with IAS 38 references the December 31, 2008 version of IAS 38.

Scope

- BC3. The Board considered whether powers and rights conferred by legislation, a constitution, or by equivalent means should be included in the scope of the Standard. The Board has not formed a view on this topic and therefore, these powers and rights are excluded from the scope of this Standard. The Board is currently developing a Conceptual Framework and will reconsider, if necessary, the applicability of this Standard to powers and rights conferred by legislation, a constitution, or by equivalent means.
- BC4. IAS 38 contains requirements and guidance on goodwill and intangible assets acquired in a business combination. The IPSASB considered whether goodwill and intangible assets acquired in a business combination should be included in the scope of this Standard. The IPSASB has not yet issued an IPSAS dealing with business combinations and considers it likely that a number of public sector specific issues will arise when combinations of public sector entities take place. The IPSASB concluded that goodwill and intangible assets acquired in a business combination should not be included in the scope of this Standard. In accordance with the hierarchy in IPSAS 3, *Accounting Policies, Changes in Accounting Policies and Errors*, users are referred to the requirements of the relevant international or national accounting standards dealing with goodwill and intangible assets acquired in a business combination.
- BC5. IAS 38 contains requirements on exchanges of assets when the exchange transaction lacks commercial substance. The IPSASB considered whether

this guidance is necessary and concluded that it was not necessary because this issue is addressed in IPSAS 23.

- BC6. The IASB has issued an Interpretation of IAS 38 dealing with accounting for website costs. The IPSASB believes the guidance contained in SIC 32 is relevant to the public sector. Accordingly, IPSAS 31 includes as application guidance the definitions and guidance contained in SIC 32. This application guidance is an integral part of IPSAS 31. The appendix in SIC 32 that illustrates the relevant accounting principles and how they are linked to IPSAS 31 is included in the illustrative examples.
- BC7. The Standard does not address emissions trading schemes. The IPSASB noted that, emissions trading schemes a government has established are a type of powers and rights conferred by legislation, a constitution, or by equivalent means, which are excluded from the scope of the Standard (see paragraph BC3). A government may acquire permits under emissions trading schemes. The treatment of such permits is currently being studied by some international and national standard-setting bodies and a consensus has not been reached on the appropriate accounting treatment. The IPSASB will reconsider, if necessary, the applicability of this Standard to emissions trading schemes.

Intangible Assets Acquired through a Non-Exchange Transaction

- BC8. IPSAS 23 prescribes the initial recognition, initial measurement and disclosure of assets and liabilities arising from non-exchange revenue transactions. This Standard addresses the circumstance where an intangible asset is acquired through a non-exchange transaction. The IPSASB agreed that, for intangible assets arising from such transactions, an entity applies the requirements of IPSAS 23 in conjunction with this Standard for initial measurement of the intangible asset and, accordingly, considers directly attributable costs specified in this Standard.

Revaluation Model

- BC9. The revaluation model proposed in IPSAS 31 is similar to that in IAS 38 which requires revaluations to be accounted for on an asset-by-asset basis. IPSAS 17, *Property, Plant, and Equipment* requires revaluations to be accounted for by class of asset rather than by individual asset. The IPSASB considered this approach for intangible assets, but concluded that it was not necessary because intangible assets differ from property, plant, and equipment in that they are less likely to be homogeneous. One of the major types of intangible assets of public sector entities is internally-developed software, for which detailed information is available on an individual asset basis. Consequently, the IPSASB concluded that it was appropriate to require revalued intangible assets to be accounted for on an asset-by-asset basis.

ILLUSTRATIVE EXAMPLES

CONTENTS

	Paragraph
Recognition and Measurement of an Internally-Generated Intangible Asset	IE1–IE5
Example Applying Paragraph 63 of this Standard	IE1–IE4
Example Applying Paragraphs 55–65 of this Standard	IE5
Assessing the Useful Lives of Intangible Assets	IE6–IE21
An Acquired Patent with a Finite Useful Life	IE8–IE9
An Acquired Patent with an Indefinite Useful Life	IE10–IE11
An Acquired Copyright that has a Remaining Legal Life of 50 Years	IE12–IE13
An Acquired Broadcasting License that Expires in Five Years—Part A	IE14–IE15
An Acquired Broadcasting License that Expires in Five Years—Part B	IE16–IE17
An Acquired Right to Operate a Public Transit Route Between Two Cities that Expires in Three Years	IE18–IE19
An Acquired List of Property Owners	IE20–IE21
Examples Illustrating the Application Guidance	IE22

Illustrative Examples

These examples accompany, but are not part of, IPSAS 31.

Recognition and Measurement of an Internally-Generated Intangible Asset

Example Applying Paragraph 63 of this Standard

- IE1. An entity developed a new system to schedule court cases more effectively that will result in increased service delivery. During the financial year ending March 31, 20X8, expenditure incurred for the development of the system was CU1,000,¹ of which CU900 was incurred before March 1, 20X8 and CU100 was incurred between March 1, 20X8 and March 31, 20X8. The entity is able to demonstrate that, at March 1, 20X8, the newly developed system met the criteria for recognition as an intangible asset. The recoverable service amount of the system (including future cash outflows to complete the development before it is available for use) is estimated to be CU500.
- IE2. At the end of the financial year, the developed system is recognized as an intangible asset at a cost of CU100 (expenditure incurred since the date when the recognition criteria were met, i.e., March 1, 20X8). The CU900 expenditure incurred before March 1, 20X8 is recognized as an expense because the recognition criteria were not met until March 1, 20X8. This expenditure does not form part of the cost of the system recognized in the statement of financial position.
- IE3. During the financial year ending March 31, 20X9, expenditure incurred is CU2,000. At the end of this financial year, the recoverable service amount of the system (including future cash outflows to complete the system before it is available for use) is estimated to be CU1,900.
- IE4. As at March 31, 20X9, the cost of the developed system is CU2,100 (CU100 expenditure recognized at the end of 20X8 plus CU2,000 expenditure recognized in the 20X9 financial year). The entity recognizes an impairment loss of CU200 to adjust the carrying amount of the developed system before the impairment loss (CU2,100) to its recoverable service amount (CU1,900). This impairment loss will be reversed in a subsequent period if the requirements for the reversal of an impairment loss in IPSAS 21 are met.

Example Applying Paragraphs 55–65 of this Standard

- IE5. An entity is developing a system which produces statistical reports for its internal use and for sale to third-parties. The system is technically feasible, the entity is aware that there is a demand for this type of report and which third-parties are willing to pay for the product and therefore will generate

¹ In this Standard, monetary amounts are denominated in “currency units” (CU).

probable future economic benefits. The expenditure attributable to the development of this system can be identified and measured reliably.

Assessing the Useful Lives of Intangible Assets

- IE6. The following guidance provides examples on determining the useful life of an intangible asset in accordance with this Standard.
- IE7. Each of the following examples describes an acquired intangible asset, the facts and circumstances surrounding the determination of its useful life, and the subsequent accounting based on that determination.

An Acquired Patent with a Finite Useful Life

- IE8. Entity A acquires a patent over a formula for a vaccine, from Entity B to secure Entity A's ability to provide free vaccinations to its constituents. The vaccine protected by the patent is expected to be a source of service potential for at least 15 years. Entity A has a commitment from Entity C to purchase that patent in five years for 60 per cent of the fair value of the patent at the date it was acquired, and Entity A intends to sell the patent in five years.
- IE9. The patent would be amortized over its five-year useful life to Entity A, with a residual value equal to 60 per cent of the patent's fair value at the date it was acquired. The patent would also be reviewed for impairment in accordance with IPSAS 21.

An Acquired Patent with an Indefinite Useful Life

- IE10. Entity A acquires an asset, the patent over a formula for a vaccine, from Entity B to secure Entity A's ability to provide free vaccinations to its constituents. It is expected that the formula will need to be slightly modified every 10 years to maintain its efficacy. There is evidence to support ongoing renewal of the patent. A contract with Entity B stipulates that Entity B will maintain the efficacy of the formula continuously, and evidence supports its ability to do so. The costs to renew the patent and maintain the efficacy of the formula are expected to be insignificant and will be paid to the Entity B when the improvements are made.
- IE11. An analysis of product lifecycle studies, and demographic and environmental trends, provides evidence that the patent will provide service potential to Entity A by enabling it to deliver its vaccination program for an indefinite period. Accordingly, the patent would be treated as having an indefinite useful life. Therefore, the patent would not be amortized unless its useful life is determined to be finite. The patent would be tested for impairment in accordance with IPSAS 21.

An Acquired Copyright that has a Remaining Legal Life of 50 Years

- IE12. Entity A acquires a copyright from Entity B to enable it to reproduce and sell the copyrighted material on a cost-recovery basis to its constituency. An analysis of the habits of the entity's constituency and other trends provides evidence that the copyrighted material will generate net cash inflows for only 30 more years.
- IE13. The copyright would be amortized over its 30-year estimated useful life. The copyright also would be reviewed for impairment in accordance with IPSAS 21.

An Acquired Broadcasting License that Expires in Five Years—Part A

- IE14. Entity A acquires a broadcasting license from Entity B. Entity A intends to provide free broadcasting services in the community. The broadcasting license is renewable every 10 years if Entity A provides at least an average level of service to its users of its service and complies with the relevant legislative requirements. The license may be renewed indefinitely at little cost and has been renewed twice before the most recent acquisition. Entity A intends to renew the license indefinitely and evidence supports its ability to do so. Historically, there has been no compelling challenge to the license renewal. The technology used in broadcasting is not expected to be replaced by another technology at any time in the foreseeable future. Therefore, the license is expected to contribute to Entity A's ability to provide free broadcasting services indefinitely.
- IE15. Entity B does not recognize its power to grant broadcasting licenses as an intangible asset. The broadcasting license would be treated by Entity A as having an indefinite useful life because it is expected to contribute to the entity's ability to provide free broadcasting services indefinitely. Therefore, the license would not be amortized until its useful life is determined to be finite. The license would be tested for impairment in accordance with IPSAS 21.

An Acquired Broadcasting License that Expires in Five Years—Part B

- IE16. The licensing authority subsequently decides that it will no longer renew broadcasting licenses, but rather will auction the licenses. At the time the licensing authority's decision is made, Entity A's broadcasting license has three years until it expires. Entity A expects that the license will continue to provide service potential until the license expires.
- IE17. Because the broadcasting license can no longer be renewed, its useful life is no longer indefinite. Thus, the acquired license would be amortized by Entity A over its remaining three-year useful life and immediately tested for impairment in accordance with IPSAS 21.

An Acquired Right to Operate a Public Transit Route Between Two Cities that Expires in Three Years

- IE18. Entity A acquires from Entity B a right to operate a public transit route between two cities, which generates revenues. The transit route may be renewed every five years, and Entity A intends to comply with the applicable rules and regulations surrounding renewal. Transit route renewals are routinely granted at a minimal cost and historically have been renewed when the entity that holds the rights to the route has complied with the applicable rules and regulations. Entity A expects to provide transit services on the route indefinitely. An analysis of demand and cash flows supports those assumptions.
- IE19. Because the facts and circumstances support the public transit route providing cash flows to Entity A for an indefinite period of time, the intangible asset related to the transit route is treated as having an indefinite useful life. Therefore, the intangible asset would not be amortized until its useful life is determined to be finite. It would be tested for impairment in accordance with IPSAS 26 annually and whenever there is an indication that it may be impaired.

An Acquired List of Property Owners

- IE20. A local authority (Entity A) acquires a list of property owners from another public sector entity which is responsible for registering property deeds (Entity B). Entity B is at another level of government, and is not part of Entity A's reporting entity. Entity A intends to use the list to generate tax revenues and Entity A expects that it will be able to derive benefit from the information on the acquired list² for at least one year, but no more than three years.
- IE21. The list of property owners would be amortized over Entity A's best estimate of its useful life, say 18 months. Although Entity B may intend to add property owner names and other information to the list in the future, the expected benefits to Entity A of the acquired list relate only to the property owners on that list at the date Entity A acquired the list. The list of property owners also would be reviewed for impairment in accordance with IPSAS 21 by assessing annually and whenever there is any indication that it may be impaired.

² Although the local authority may intend to add property owners and other information to the database in the future, the expected benefits of the acquired database relate only to the property owners on that database at the date it was acquired. Subsequent additions would be considered to be internally-developed intangible assets, and accounted for in accordance with this Standard.

Examples Illustrating the Application Guidance

- IE22. The purpose of the table is to illustrate examples of expenditure that occur during each of the stages described in paragraphs AG2–AG3 and to illustrate application of paragraphs AG4–AG11 to assist in clarifying their meaning. It is not intended to be a comprehensive checklist of expenditure that might be incurred.

STAGE/NATURE OF EXPENDITURE	ACCOUNTING TREATMENT
Planning	
<ul style="list-style-type: none"> • Undertaking feasibility studies; • Defining hardware and software specifications; • Evaluating alternative products and suppliers; and • Selecting preferences. 	Recognize as an expense when incurred in accordance with paragraph 52 of this Standard.
Application and Infrastructure Development	
<ul style="list-style-type: none"> • Purchasing or developing hardware. • Obtaining a domain name; • Developing operating software (e.g., operating system and server software); • Developing code for the application; • Installing developed applications on the web server; and • Stress testing. 	Apply the requirements of IPSAS 17. Recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55 ³ of this Standard.
Graphical Design Development	
<ul style="list-style-type: none"> • Designing the appearance (e.g., layout and color) of web pages. 	Recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55 ⁴ of this Standard.
Content Development	
<ul style="list-style-type: none"> • Creating, purchasing, preparing (e.g., creating links and identifying tags), and uploading 	Recognize as an expense when incurred in accordance with paragraph 67(c) of this Standard to the extent that content

³ All expenditure on developing a website solely or primarily for promoting, advertising, or providing information to the public at large regarding the entity's own products and services is recognized an expense when incurred in accordance with paragraph 66 of this Standard.

⁴ See footnote 3.

STAGE/NATURE OF EXPENDITURE	ACCOUNTING TREATMENT
<p>information, either textual or graphic in nature, on the website before the completion of the website's development. Examples of content include information about an entity, services, or products, and topics that subscribers access.</p>	<p>is developed to advertise and promote an entity's own services and products (e.g., digital photographs of products). Otherwise, recognize as an expense when incurred, unless the expenditure can be directly attributed to preparing the website to operate in the manner intended by management, and the website meets the recognition criteria in paragraphs 28 and 55⁵ of this Standard.</p>
Operating	
<ul style="list-style-type: none"> • Updating graphics and revising content; • Adding new functions, features, and content; • Registering the website with search engines; • Backing up data; • Reviewing security access; and • Analyzing usage of the website. 	<p>Assess whether it meets the definition of an intangible asset and the recognition criteria set out in paragraph 28 of this Standard, in which case the expenditure is recognized in the carrying amount of the website asset.</p>
Other	
<ul style="list-style-type: none"> • Selling, administrative, and other general overhead expenditure unless it can be directly attributed to preparing the website for use to operate in the manner intended by management; • Clearly identified inefficiencies and initial operating deficits incurred before the website achieves planned performance (e.g., false-start testing); and • Training employees to operate the website. 	<p>Recognize as an expense when incurred in accordance with paragraphs 63–69 of this Standard.</p>

⁵ See footnote 3.

Comparison with IAS 38

IPSAS 31, *Intangible Assets* is drawn primarily from IAS 38, *Intangible Assets* (as at December 31, 2008). The main differences between IPSAS 31 and IAS 38 are as follows:

- IPSAS 31 includes a scope exclusion for the powers and rights conferred by legislation, a constitution, or by equivalent means.
- IPSAS 31 incorporates the guidance contained in the Standing Interpretation Committee's Interpretation 32, *Intangible Assets—Web Site Costs* as Application Guidance to illustrate the relevant accounting principles.
- IPSAS 31 does not require or prohibit the recognition of intangible heritage assets. An entity that recognizes intangible heritage assets is required to comply with the disclosure requirements of this Standard with respect to those intangible heritage assets that have been recognized and may, but is not required to, comply with other requirements of this Standard in respect of those intangible heritage assets. IAS 38 does not have similar guidance.
- IAS 38 contains requirements and guidance on goodwill and intangible assets acquired in a business combination. IPSAS 31 does not include this guidance.
- IAS 38 contains guidance on intangible assets acquired by way of a government grant. Paragraphs 50–51 of IPSAS 31 modify this guidance to refer to intangible assets acquired through non-exchange transactions. IPSAS 31 states that where an intangible asset is acquired through a non-exchange transaction, the cost is its fair value as at the date it is acquired.
- IAS 38 provides guidance on exchanges of assets when an exchange transaction lacks commercial substance. IPSAS 31 does not include this guidance.
- The examples included in IAS 38 have been modified to better address public sector circumstances.
- IPSAS 31 uses different terminology, in certain instances, from IAS 38. The most significant examples are the use of the terms “revenue,” “statement of financial performance,” “surplus or deficit,” “future economic benefits or service potential,” “accumulated surpluses or deficits,” “operating/operation,” “rights from binding arrangements (including rights from contracts or other legal rights),” and “net assets/equity” in IPSAS 31. The equivalent terms in IAS 38 are “income,” “statement of comprehensive income,” “profit or loss,” “future economic benefits,” “retained earnings,” “business,” “contractual or other legal rights,” and “equity.”

IPSAS 32—SERVICE CONCESSION ARRANGEMENTS: GRANTOR

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) sets out the accounting requirements of the grantor in a service concession arrangement. It is adapted from Interpretation 12 (IFRIC 12), *Service Concession Arrangements*, developed by the International Financial Reporting Interpretations Committee and published by the International Accounting Standards Board (IASB). IFRIC 12 sets out the accounting requirements of the operator in a service concession arrangement. This IPSAS also contains extracts from Interpretation 29 (SIC-29), *Service Concession Arrangements: Disclosures*, developed by the Standing Interpretations Committee and published by the IASB. Extracts from IFRIC 12 and SIC-29 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Financial Reporting Standards (IFRS) Foundation.

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

E-mail: publications@ifrs.org

Internet: www.ifrs.org

IFRSs, IASs, Exposure Drafts, and other publications of the IASB are copyright of the IFRS Foundation.

“IFRS,” “IAS,” “IASB,” “IFRS Foundation,” “International Accounting Standards,” and “International Financial Reporting Standards” are trademarks of the IFRS Foundation and should not be used without the approval of the IFRS Foundation.

IPSAS 32—SERVICE CONCESSION ARRANGEMENTS: GRANTOR

History of IPSAS

This version includes amendments resulting from IPSASs issued up to January 15, 2014.

IPSAS 32, *Service Concession Arrangements: Grantor* was issued in October 2011.

IPSAS 32—SERVICE CONCESSION ARRANGEMENTS: GRANTOR

CONTENTS

	Paragraph
Objective	1
Scope	2–7
Definitions	8
Recognition and Measurement of a Service Concession Asset	9–13
Recognition and Measurement of Liabilities	14–28
Financial Liability Model	18–23
Grant of a Right to the Operator Model	24–26
Dividing the Arrangement	27–28
Other Liabilities, Commitments, Contingent Liabilities, and Contingent Assets	29
Other Revenues	30
Presentation and Disclosure	31–33
Transition	34–35
Effective Date	36–37
Appendix A: Application Guidance	
Appendix B: Amendments to Other IPSASs	
Basis for Conclusions	
Implementation Guidance	
Illustrative Examples	

International Public Sector Accounting Standard 32, *Service Concession Arrangements: Grantor* is set out in paragraphs 1–37. All the paragraphs have equal authority. IPSAS 32 should be read in the context of its objective, the Basis for Conclusions, and the *Preface to International Public Sector Accounting Standards*. IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*, provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Objective

1. The objective of this Standard is to prescribe the accounting for service concession arrangements by the grantor, a public sector entity.

Scope (see paragraphs AG1–AG2)

2. **An entity¹ that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for service concession arrangements.**
3. **This Standard applies to all public sector entities other than Government Business Enterprises.**
4. The *Preface to International Public Sector Accounting Standards* issued by the IPSASB explains that Government Business Enterprises (GBEs) apply IFRSs issued by the IASB. GBEs are defined in IPSAS 1, *Presentation of Financial Statements*.
5. Arrangements within the scope of this Standard involve the operator providing public services related to the service concession asset on behalf of the grantor.
6. Arrangements outside the scope of this Standard are those that do not involve the delivery of public services and arrangements that involve service and management components where the asset is not controlled by the grantor (e.g., outsourcing, service contracts, or privatization).
7. This Standard does not specify the accounting by operators (guidance on accounting for service concession arrangements by the operator can be found in the relevant international or national accounting standard dealing with service concession arrangements).

Definitions (see paragraphs AG3–AG4)

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

A binding arrangement, for the purposes of this Standard, describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract.

A grantor, for the purposes of this Standard, is the entity that grants the right to use the service concession asset to the operator.

An operator, for the purposes of this Standard, is the entity that uses the service concession asset to provide public services subject to the grantor's control of the asset.

¹ An entity for the purposes of this Standard is referred to as the grantor.

A **service concession arrangement** is a binding arrangement between a grantor and an operator in which:

- (a) The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and
- (b) The operator is compensated for its services over the period of the service concession arrangement.

A **service concession asset** is an asset used to provide public services in a service concession arrangement that:

- (a) Is provided by the operator which:
 - (i) The operator constructs, develops, or acquires from a third party; or
 - (ii) Is an existing asset of the operator; or
- (b) Is provided by the grantor which:
 - (i) Is an existing asset of the grantor; or
 - (ii) Is an upgrade to an existing asset of the grantor.

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

Recognition and Measurement of a Service Concession Asset (see paragraphs AG5–AG35)

9. The grantor shall recognize an asset provided by the operator and an upgrade to an existing asset of the grantor as a service concession asset if:
 - (a) The grantor controls or regulates what services the operator must provide with the asset, to whom it must provide them, and at what price; and
 - (b) The grantor controls—through ownership, beneficial entitlement or otherwise—any significant residual interest in the asset at the end of the term of the arrangement.
10. This Standard applies to an asset used in a service concession arrangement for its entire useful life (a “whole-of-life” asset) if the conditions in paragraph 9(a) are met.
11. The grantor shall initially measure the service concession asset recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) at its fair value, except as noted in paragraph 12.

12. **Where an existing asset of the grantor meets the conditions specified in paragraph 9(a) and 9(b) (or paragraph 10 for a whole-of-life asset), the grantor shall reclassify the existing asset as a service concession asset. The reclassified service concession asset shall be accounted for in accordance with IPSAS 17, *Property, Plant, and Equipment* or IPSAS 31, *Intangible Assets*, as appropriate.**
13. **After initial recognition or reclassification, service concession assets shall be accounted for as a separate class of assets in accordance with IPSAS 17 or IPSAS 31, as appropriate.**

Recognition and Measurement of Liabilities (see paragraphs AG36–AG50)

14. **Where the grantor recognizes a service concession asset in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor shall also recognize a liability. The grantor shall not recognize a liability when an existing asset of the grantor is reclassified as a service concession asset in accordance with paragraph 12, except in circumstances where additional consideration is provided by the operator, as noted in paragraph 15.**
15. **The liability recognized in accordance with paragraph 14 shall be initially measured at the same amount as the service concession asset measured in accordance with paragraph 11, adjusted by the amount of any other consideration (e.g., cash) from the grantor to the operator, or from the operator to the grantor.**
16. The nature of the liability recognized is based on the nature of the consideration exchanged between the grantor and the operator. The nature of the consideration given by the grantor to the operator is determined by reference to the terms of the binding arrangement and, when relevant, contract law.
17. In exchange for the service concession asset, the grantor may compensate the operator for the service concession asset by any combination of:
 - (a) Making payments to the operator (the “financial liability” model);
 - (b) Compensating the operator by other means (the “grant of a right to the operator” model) such as:
 - (i) Granting the operator the right to earn revenue from third-party users of the service concession asset; or
 - (ii) Granting the operator access to another revenue-generating asset for the operator’s use (e.g., a private wing of a hospital where the remainder of the hospital is used by the grantor to treat

public patients or a private parking facility adjacent to a public facility).

Financial Liability Model (see paragraphs AG37–AG46)

18. **Where the grantor has an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, the grantor shall account for the liability recognized in accordance with paragraph 14 as a financial liability.**
19. The grantor has an unconditional obligation to pay cash if it has guaranteed to pay the operator:
 - (a) Specified or determinable amounts; or
 - (b) The shortfall, if any, between amounts received by the operator from users of the public service and any specified or determinable amounts referred to in paragraph 19(a), even if the payment is contingent on the operator ensuring that the service concession asset meets specified quality or efficiency requirements.
20. IPSAS 28, *Financial Instruments: Presentation*, the derecognition requirements in IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures* apply to the financial liability recognized under paragraph 14, except where this Standard provides requirements and guidance.
21. **The grantor shall allocate the payments to the operator and account for them according to their substance as a reduction in the liability recognized in accordance with paragraph 14, a finance charge, and charges for services provided by the operator.**
22. **The finance charge and charges for services provided by the operator in a service concession arrangement determined in accordance with paragraph 21 shall be accounted for as expenses.**
23. **Where the asset and service components of a service concession arrangement are separately identifiable, the service components of payments from the grantor to the operator shall be allocated by reference to the relative fair values of the service concession asset and the services. Where the asset and service components are not separately identifiable, the service component of payments from the grantor to the operator is determined using estimation techniques.**

Grant of a Right to the Operator Model (see paragraphs AG47–AG49)

24. **Where the grantor does not have an unconditional obligation to pay cash or another financial asset to the operator for the construction, development, acquisition, or upgrade of a service concession asset, and**

grants the operator the right to earn revenue from third-party users or another revenue-generating asset, the grantor shall account for the liability recognized in accordance with paragraph 14 as the unearned portion of the revenue arising from the exchange of assets between the grantor and the operator.

25. **The grantor shall recognize revenue and reduce the liability recognized in accordance with paragraph 24 according to the economic substance of the service concession arrangement.**
26. Where the grantor compensates the operator for the service concession asset and the provision of services by granting the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset, the exchange is regarded as a transaction that generates revenue. As the right granted to the operator is effective for the period of the service concession arrangement, the grantor does not recognize revenue from the exchange immediately. Instead, a liability is recognized for any portion of the revenue that is not yet earned. The revenue is recognized according to the economic substance of the service concession arrangement, and the liability is reduced as revenue is recognized.

Dividing the Arrangement (see paragraph AG50)

27. **If the grantor pays for the construction, development, acquisition, or upgrade of a service concession asset partly by incurring a financial liability and partly by the grant of a right to the operator, it is necessary to account separately for each part of the total liability recognized in accordance with paragraph 14. The amount initially recognized for the total liability shall be the same amount as that specified in paragraph 15.**
28. **The grantor shall account for each part of the liability referred to in paragraph 27 in accordance with paragraphs 18–26.**

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets (see paragraphs AG51–AG54)

29. **The grantor shall account for other liabilities, commitments, contingent liabilities, and contingent assets arising from a service concession arrangement in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*, IPSAS 28, IPSAS 29, and IPSAS 30.**

Other Revenues (see paragraphs AG55–AG64)

30. **The grantor shall account for revenues from a service concession arrangement, other than those specified in paragraphs 24–26, in accordance with IPSAS 9, *Revenue from Exchange Transactions*.**

Presentation and Disclosure (see paragraphs AG65–AG67)

31. The grantor shall present information in accordance with IPSAS 1.
32. All aspects of a service concession arrangement shall be considered in determining the appropriate disclosures in the notes. A grantor shall disclose the following information in respect of service concession arrangements in each reporting period:
 - (a) A description of the arrangement;
 - (b) Significant terms of the arrangement that may affect the amount, timing, and certainty of future cash flows (e.g., the period of the concession, re-pricing dates, and the basis upon which re-pricing or re-negotiation is determined);
 - (c) The nature and extent (e.g., quantity, time period, or amount, as appropriate) of:
 - (i) Rights to use specified assets;
 - (ii) Rights to expect the operator to provide specified services in relation to the service concession arrangement;
 - (iii) Service concession assets recognized as assets during the reporting period, including existing assets of the grantor reclassified as service concession assets;
 - (iv) Rights to receive specified assets at the end of the service concession arrangement;
 - (v) Renewal and termination options;
 - (vi) Other rights and obligations (e.g., major overhaul of service concession assets); and
 - (vii) Obligations to provide the operator with access to service concession assets or other revenue-generating assets; and
 - (d) Changes in the arrangement occurring during the reporting period.
33. The disclosures required in accordance with paragraph 32 are provided individually for each material service concession arrangement or in aggregate for each class of service concession arrangements. A class is a grouping of service concession arrangements involving services of a similar nature (e.g., toll collections, telecommunications or water treatment services). This disclosure by class of service concession asset is in addition to that required in paragraph 13 by class of asset. For example, for the purposes of paragraph 13 a toll bridge may be grouped with other bridges. For the purposes of this paragraph, the toll bridge may be grouped with toll roads.

Transition (see paragraphs AG68–AG73)

34. A grantor that has previously recognized service concession assets and related liabilities, revenues, and expenses shall apply this Standard retrospectively in accordance with IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors*.
35. A grantor that has not previously recognized service concession assets and related liabilities, revenues, and expenses shall either:
 - (a) Apply this Standard retrospectively in accordance with IPSAS 3; or
 - (b) Elect to recognize and measure service concession assets and related liabilities at the beginning of the earliest period for which comparative information is presented in the financial statements.

When the grantor makes this election, it shall disclose this fact, along with disclosures relating to the measurement of those assets and liabilities.

Effective Date

36. An entity shall apply this Standard for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2014, it shall disclose that fact and apply IPSAS 5, *Borrowing Costs*, IPSAS 13, *Leases*, IPSAS 17, IPSAS 29, and IPSAS 31 at the same time.
37. When an entity adopts the accrual basis of accounting as defined by IPSASs for financial reporting purposes subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption.

Appendix A

Application Guidance

This Appendix is an integral part of IPSAS 32.

Scope (see paragraphs 2–7)

AG1. This Standard is intended to “mirror” Interpretation 12 of the International Financial Reporting Interpretations Committee, *Service Concession Arrangements* (IFRIC 12), which sets out the accounting requirements for the private sector operator in a service concession arrangement. To do so, the scope, principles for recognition of an asset, and terminology are consistent with the applicable guidance in IFRIC 12. However, because this Standard deals with the accounting issues of the grantor, this Standard addresses the issues identified in IFRIC 12 from the grantor’s point of view, as follows:

- (a) The grantor recognizes a financial liability when it is obliged to make a series of payments to the operator for provision of a service concession asset (i.e., constructed, developed, acquired, or upgraded). Using the measurement requirements specified in this Standard under paragraphs 12, 14, and 20 of IFRIC 12, the operator recognizes revenue for the construction, development, acquisition, upgrade, and operation services it provides. Under paragraph 8 of IFRIC 12, the operator derecognizes an asset that it held and recognized as property, plant, and equipment before entering the service concession arrangement.
- (b) The grantor recognizes a liability when it grants the operator the right to earn revenue from third-party users of the service concession asset or another revenue-generating asset. Under paragraph 26 of IFRIC 12, the operator recognizes an intangible asset.
- (c) The grantor derecognizes an asset it grants to the operator and over which it no longer has control. Under paragraph 27 of IFRIC 12, the operator recognizes the asset and a liability in respect of any obligations it has assumed in exchange for the asset.

AG2. Paragraph 9 of this Standard specifies the conditions under which an asset, other than a whole-of-life asset, is within the scope of the Standard. Paragraph 10 of the Standard specifies the condition under which whole-of-life assets are within the scope of the Standard.

Definitions (see paragraph 8)

AG3. Paragraph 8 defines a service concession arrangement. Common features of a service concession arrangement are:

- (a) The grantor is a public sector entity;
- (b) The operator is responsible for at least some of the management of the service concession asset and related services and does not merely act as an agent on behalf of the grantor;
- (c) The arrangement sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement;
- (d) The operator is obliged to hand over the service concession asset to the grantor in a specified condition at the end of the period of the arrangement, for little or no incremental consideration, irrespective of which party initially financed it; and
- (e) The arrangement is governed by a binding arrangement that sets out performance standards, mechanisms for adjusting prices, and arrangements for arbitrating disputes.

AG4. Paragraph 8 defines a service concession asset. Examples of service concession assets are: roads, bridges, tunnels, prisons, hospitals, airports, water distribution facilities, energy supply and telecommunication networks, permanent installations for military and other operations, and other non-current tangible or intangible assets used for administrative purposes in delivering public services.

Recognition and Initial Measurement of a Service Concession Asset (see paragraphs 9–13)

Recognition of a Service Concession Asset

- AG5. The assessment of whether a service concession asset should be recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) is made on the basis of all of the facts and circumstances of the arrangement.
- AG6. The control or regulation referred to in paragraph 9(a) could be by a binding arrangement, or otherwise (such as through a third party regulator that regulates other entities that operate in the same industry or sector as the grantor), and includes circumstances in which the grantor buys all of the output as well as those in which some or all of the output is bought by other users. The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. The binding arrangement sets the initial prices to be levied by the operator and regulates price revisions over the period of the service concession arrangement. When the binding arrangement conveys the right to control the use of the service concession asset to the grantor, the asset meets the condition specified in paragraph 9(a) regarding control in relation to those to whom the operator must provide services.

- AG7. For the purpose of paragraph 9(a), the grantor does not need to have complete control of the price: it is sufficient for the price to be regulated by the grantor, binding arrangement, or a third party regulator that regulates other entities that operate in the same industry or sector (e.g., hospitals, schools, or universities) as the grantor (e.g., by a capping mechanism). However, the condition is applied to the substance of the agreement. Non-substantive features, such as a cap that will apply only in remote circumstances, are ignored. Conversely, if, for example, an arrangement purports to give the operator freedom to set prices, but any excess profit is returned to the grantor, the operator's return is capped and the price element of the control test is met.
- AG8. Many governments have the power to regulate the behavior of entities operating in certain sectors of the economy, either directly, or through specifically created agencies. For the purpose of paragraph 9(a), the broad regulatory powers described above do not constitute control. In this Standard, the term "regulate" is intended to be applied only in the context of the specific terms and conditions of the service concession arrangement. For example, a regulator of rail services may determine rates that apply to the rail industry as a whole. Depending on the legal framework in a jurisdiction, such rates may be implicit in the binding arrangement governing a service concession arrangement involving the provision of railway transportation, or they may be specifically referred to therein. However, in both cases, the control of the service concession asset is derived from either the contract, or similar binding arrangement, or from the specific regulation applicable to rail services and not from the fact that the grantor is a public sector entity that is related to the regulator of rail service.
- AG9. For the purpose of paragraph 9(b), the grantor's control over any significant residual interest should both restrict the operator's practical ability to sell or pledge the asset and give the grantor a continuing right of use throughout the period of the service concession arrangement. The residual interest in the asset is the estimated current value of the asset as if it were already of the age and in the condition expected at the end of the period of the service concession arrangement.
- AG10. Control should be distinguished from management. If the grantor retains both the degree of control described in paragraph 9(a) and any significant residual interest in the asset, the operator is only managing the asset on the grantor's behalf—even though, in many cases, it may have wide managerial discretion.
- AG11. The conditions in paragraphs 9(a) and 9(b) together identify when the asset, including any replacements required, is controlled by the grantor for the whole of its economic life. For example, if the operator has to replace part of an asset during the period of the arrangement (e.g., the top layer of a road or the roof of a building), the asset is considered as a whole. Thus the

condition in paragraph 9(b) is met for the whole of the asset, including the part that is replaced, if the grantor controls any significant residual interest in the final replacement of that part.

AG12. Sometimes the use of a service concession asset is partly regulated in the manner described in paragraph 9(a) and partly unregulated. However, these arrangements take a variety of forms:

- (a) Any asset that is physically separable and capable of being operated independently and meets the definition of a cash-generating unit as defined in IPSAS 26, *Impairment of Cash-Generating Assets* is analyzed separately to determine whether the condition set out in paragraph 9(a) is met if it is used wholly for unregulated purposes (e.g., this might apply to a private wing of a hospital, where the remainder of the hospital is used by the grantor to treat public patients); and
- (b) When purely ancillary activities (such as a hospital shop) are unregulated, the control tests are applied as if those services did not exist, because in cases in which the grantor controls the services in the manner described in paragraph 9(a), the existence of ancillary activities does not detract from the grantor's control of the service concession asset.

AG13. The operator may have a right to use the separable asset described in paragraph AG12(a), or the facilities used to provide ancillary unregulated services described in paragraph AG12(b). In either case, there may in substance be a lease from the grantor to the operator; if so, it is accounted for in accordance with IPSAS 13.

Existing Asset of the Grantor

AG14. The arrangement may involve an existing asset of the grantor:

- (a) To which the grantor gives the operator access for the purpose of the service concession arrangement; or
- (b) To which the grantor gives the operator access for the purpose of generating revenues as compensation for the service concession asset.

AG15. The requirement in paragraph 11 is to measure assets recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) initially at fair value. Existing assets of the grantor used in the service concession arrangement are reclassified rather than recognized under this Standard. Only an upgrade to an existing asset of the grantor (e.g., that increases its capacity) is recognized as a service concession asset in accordance with paragraph 9, or paragraph 10 for a whole-of-life asset).

- AG16. In applying the impairment tests in IPSAS 17 or IPSAS 31, as appropriate, the grantor does not necessarily consider the granting of the service concession to the operator as a circumstance that causes impairment, unless there has been a change in use of the asset that affects its future economic benefits or service potential. The grantor refers to IPSAS 21, *Impairment of Non-Cash-Generating Assets* or IPSAS 26, as appropriate, to determine whether any of the indicators of impairment have been triggered under such circumstances.
- AG17. If the asset no longer meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset), the grantor follows the derecognition principles in IPSAS 17 or IPSAS 31, as appropriate. For example, if the asset is transferred to the operator on a permanent basis, it is derecognized. If the asset is transferred on a temporary basis, the grantor considers the substance of this term of the service concession arrangement in determining whether the asset should be derecognized. In such cases, the grantor also considers whether the arrangement is a lease transaction or a sale and leaseback transaction that should be accounted for in accordance with IPSAS 13.
- AG18. When the service concession arrangement involves upgrading an existing asset of the grantor such that the future economic benefits or service potential the asset will provide are increased, the upgrade is assessed to determine whether it meets the conditions for recognition in paragraph 9 (or paragraph 10 for a whole-of-life asset). If those conditions are met, the upgrade is recognized and measured in accordance with this Standard.

Existing Asset of the Operator

- AG19. The operator may provide an asset for use in the service concession arrangement that it has not constructed, developed, or acquired. If the arrangement involves an existing asset of the operator which the operator uses for the purpose of the service concession arrangement, the grantor determines whether the asset meets the conditions in paragraph 9 (or paragraph 10 for a whole-of-life asset). If the conditions for recognition are met, the grantor recognizes the asset as a service concession asset and accounts for it in accordance with this Standard.

Constructed or Developed Asset

- AG20. Where a constructed or developed asset meets the conditions in paragraph 9 (or paragraph 10 for a whole-of-life asset) the grantor recognizes and measures the asset in accordance with this Standard. IPSAS 17 or IPSAS 31, as appropriate, set out the criteria for when a service concession asset should be recognized. Both IPSAS 17 and IPSAS 31 require that an asset shall be recognized if, and only if:

- (a) It is probable that future economic benefits or service potential associated with the item will flow to the entity; and
 - (b) The cost or fair value of the item can be measured reliably.
- AG21. Those criteria, together with the specific terms and conditions of the binding arrangement, need to be considered in determining whether to recognize the service concession asset during the period in which the asset is constructed or developed. For both property, plant, and equipment and intangible assets, the recognition criteria may be met during the construction or development period, and, if so, the grantor will normally recognize the service concession asset during that period.
- AG22. The first recognition criterion requires the flow of economic benefits or service potential to the grantor. From the grantor's point of view, the primary purpose of a service concession asset is to provide service potential on behalf of the public sector grantor. Similar to an asset the grantor constructs or develops for its own use, the grantor would assess, at the time the costs of construction or development are incurred, the terms of the binding arrangement to determine whether the service potential of the service concession asset would flow to the grantor at that time.
- AG23. The second recognition criterion requires that the initial cost or fair value of the asset can be measured reliably. Accordingly, to meet the recognition criteria in IPSAS 17 or IPSAS 31, as appropriate, the grantor must have reliable information about the cost or fair value of the asset during its construction or development. For example, if the service concession arrangement requires the operator to provide the grantor with progress reports during the asset's construction or development, the costs incurred may be measurable, and would therefore meet the recognition principle in IPSAS 17 for constructed assets or in IPSAS 31 for developed assets. Also, where the grantor has little ability to avoid accepting an asset constructed or developed to meet the specifications of the contract, or a similar binding arrangement, the costs are recognized as progress is made towards completion of the asset. Thus, the grantor recognizes a service concession asset and an associated liability.

Measurement of Service Concession Assets

- AG24. Paragraph 11 requires service concession assets recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset) to be measured initially at fair value. In particular, fair value is used to determine the cost of a constructed or developed service concession asset or the cost of any upgrades to existing assets, on initial recognition. The requirement in paragraph 11 does not apply to existing assets of the grantor that are reclassified as service concession assets in accordance with paragraph 12 of this Standard. The use of fair value on initial recognition does not constitute a revaluation under IPSAS 17 or IPSAS 31.

AG25. The type of compensation exchanged between the grantor and the operator affects how the fair value of the service concession asset is determined on initial recognition. The paragraphs that follow outline how to determine the fair value of the asset on initial recognition based on the type of compensation exchanged:

- (a) Where payments are made by the grantor to the operator, the fair value on initial recognition of the asset represents the portion of the payments paid to the operator for the asset.
- (b) Where the grantor does not make payments to the operator for the asset, the asset is accounted for in the same way as an exchange of non-monetary assets in IPSAS 17 and IPSAS 31.

Types of Compensation

AG26. Service concession arrangements are rarely if ever the same; technical requirements vary by sector and by jurisdiction. Furthermore, the terms of the arrangement may also depend on the specific features of the overall legal framework of the particular jurisdiction. Contract laws, where they exist, may contain terms that do not have to be repeated in individual contracts.

AG27. Depending on the terms of the service concession arrangement, the grantor may compensate the operator for the service concession asset and service provision by any combination of the following:

- (a) Making payments (e.g., cash) to the operator;
- (b) Compensating the operator by other means, such as:
 - (i) Granting the operator the right to earn revenue from third-party users of the service concession asset; or
 - (ii) Granting the operator access to another revenue-generating asset for its use.

AG28. Where the grantor compensates the operator for the service concession asset by making payments to the operator, the asset and service components of the payments may be separable (e.g., the binding arrangement specifies the amount of the predetermined series of payments to be allocated to the service concession asset) or inseparable.

Separable Payments

AG29. A service concession arrangement may be separable in a variety of circumstances, including, but not limited to, the following:

- (a) Part of a payment stream that varies according to the availability of the service concession asset itself and another part that varies according to usage or performance of certain services are identified;

- (b) Different components of the service concession arrangement run for different periods or can be terminated separately. For example, an individual service component can be terminated without affecting the continuation of the rest of the arrangement; or
- (c) Different components of the service concession arrangement can be renegotiated separately. For example, a service component is market tested and some or all of the cost increases or reductions are passed on to the grantor in such a way that the part of the payment by the grantor that relates specifically to that service can be identified.

AG30. IPSAS 17 and IPSAS 31 require initial measurement of an asset acquired in an exchange transaction at cost, which is the cash price equivalent of the asset. For exchange transactions, the transaction price is considered to be fair value, unless indicated otherwise. Where the asset and service components of payments are separable, the cash price equivalent of the service concession asset is the present value of the service concession asset component of the payments. However, if the present value of the asset portion of the payments is greater than fair value, the service concession asset is initially measured at its fair value.

Inseparable Payments

- AG31. Where the asset and service component of payments by the grantor to the operator are not separable, the fair value in paragraph 11 is determined using estimation techniques.
- AG32. For the purpose of applying the requirements of this Standard, payments and other consideration required by the arrangement are allocated at the inception of the arrangement or upon a reassessment of the arrangement into those for the service concession asset and those for other components of the service concession arrangement (e.g., maintenance and operation services) on the basis of their relative fair values. The fair value of the service concession asset includes only amounts related to the asset and excludes amounts for other components of the service concession arrangement. In some cases, allocating the payments for the asset from payments for other components of the service concession arrangement will require the grantor to use an estimation technique. For example, a grantor may estimate the payments related to the asset by reference to the fair value of a comparable asset in an agreement that contains no other components, or by estimating the payments for the other components in the service concession arrangement by reference to comparable arrangements and then deducting these payments from the total payments under the arrangement.

Operator Receives Other Forms of Compensation

- AG33. The types of transactions referred to in paragraph 17(b) are non-monetary exchange transactions. Paragraph 38 of IPSAS 17 and paragraph 44 of IPSAS 31, as appropriate, provide guidance on these circumstances.
- AG34. When the operator is granted the right to earn revenue from third-party users of the service concession asset, or another revenue-generating asset, or receives non-cash compensation from the grantor, the grantor does not incur a cost directly for acquiring the service concession asset. These forms of compensation to the operator are intended to compensate the operator both for the cost of the service concession asset and for operating it during the term of the service concession arrangement. The grantor therefore needs to initially measure the asset component in a manner consistent with paragraph 11.

Subsequent Measurement

- AG35. After initial recognition, a grantor applies IPSAS 17 and IPSAS 31 to the subsequent measurement and derecognition of a service concession asset. For the purposes of applying IPSAS 17 and IPSAS 31, service concession assets should be treated as a separate class of assets. IPSAS 21 and IPSAS 26 are also applied in considering whether there is any indication that a service concession asset is impaired. These requirements in these Standards are applied to all assets recognized or classified as service concession assets in accordance with this Standard.

Recognition and Measurement of Liabilities (see paragraphs 14–28)

- AG36. The grantor recognizes a liability in accordance with paragraph 14 only when a service concession asset is recognized in accordance with paragraph 9 (or paragraph 10 for a whole-of-life asset). The nature of the liability recognized in accordance with paragraph 14 differs in each of the circumstances described in paragraph AG25 according to its substance.

The Financial Liability Model (see paragraphs 18–23)

- AG37. When the grantor has an unconditional obligation to make a predetermined series of payments to the operator, the liability is a financial liability as defined in IPSAS 29. The grantor has an unconditional obligation if it has little, if any, discretion to avoid the obligation usually because of the binding arrangement with the operator being enforceable by law.
- AG38. When the grantor provides compensation to the operator for the cost of the service concession asset and service provision in the form of a predetermined series of payments, an amount reflecting the portion of the predetermined series of payments that pertains to the asset is recognized as a liability in accordance with paragraph 14. This liability does not include

the finance charge and service components of the payments specified in paragraph 21.

- AG39. Where the grantor makes any payments to the operator in advance of the service concession asset being recognized, the grantor accounts for those payments as prepayments.
- AG40. The finance charge specified in paragraph 21 is determined based on the operator's cost of capital specific to the service concession asset, if this is practicable to determine.
- AG41. If the operator's cost of capital specific to the service concession asset is not practicable to determine, the rate implicit in the arrangement specific to the service concession asset, the grantor's incremental borrowing rate, or another rate appropriate to the terms and conditions of the arrangement, is used.
- AG42. Where sufficient information is not available, the rate used to determine the finance charge may be estimated by reference to the rate that would be expected on acquiring a similar asset (e.g., a lease of a similar asset, in a similar location and for a similar term). The estimate of the rate should be reviewed together with:
- (a) The present value of the payments;
 - (b) The assumed fair value of the asset; and
 - (c) The assumed residual value, to ensure all figures are reasonable and mutually consistent.
- AG43. In cases when the grantor takes part in the financing (e.g., by lending the operator the funds to construct, develop, acquire, or upgrade a service concession asset, or through guarantees), it may be appropriate to use the grantor's incremental borrowing rate to determine the finance charge.
- AG44. The interest rate used to determine the finance charge may not be subsequently changed unless the asset component or the whole of the arrangement is renegotiated.
- AG45. The finance charge related to the liability in a service concession arrangement is presented consistently with other finance charges in accordance with IPSAS 28, IPSAS 29, and IPSAS 30.
- AG46. The service component of payments determined in accordance with paragraph 21 is ordinarily recognized evenly over the term of the service concession arrangement because this pattern of recognition best corresponds to the service provision. In cases when specific expenses are required to be separately compensated, and their timing is known, such expenses are recognized as incurred.

Grant of a Right to the Operator Model (see paragraphs 24–26)

- AG47. When the grantor compensates the operator for the service concession asset and service provision by granting the operator the right to earn revenue from third-party users of the service concession asset, the operator is granted the right to earn revenue over the period of the service concession arrangement. Likewise, the grantor earns the benefit associated with the assets received in the service concession arrangement in exchange for the right granted to the operator over the period of the arrangement. Accordingly, the revenue is not recognized immediately. Instead, a liability is recognized for any portion of the revenue that is not yet earned. Revenue is recognized and the liability reduced in accordance with paragraph 25 based on the economic substance of the service concession arrangement, usually as access to the service concession asset is provided to the operator over the term of the service concession arrangement. As described in paragraph AG27, the grantor may compensate the operator by a combination of payments and granting a right to earn revenue directly from third-party users. In such cases, if the operator's right to earn such third-party revenues significantly reduces or eliminates the grantor's predetermined series of payments to the operator, another basis may be more appropriate for reducing the liability (e.g., the term over which the grantor's future predetermined series of payments are reduced or eliminated).
- AG48. When the grantor compensates the operator for the service concession asset and service by the provision of a revenue-generating asset, other than the service concession asset, revenue is recognized and the liability recognized in accordance with paragraph 24 is reduced in a manner similar to that described in paragraph AG47. In such cases, the grantor also considers the derecognition requirements in IPSAS 17 or IPSAS 31, as appropriate.
- AG49. In some cases under the grant of a right to the operator model, there may be a "shadow toll". Some shadow tolls are paid for the construction, development, acquisition, or upgrade of the service concession asset, and its operation by the operator. In cases where the grantor pays the operator solely for the usage of the service concession asset by third-party users, such payment is compensation in exchange for the usage and not the acquisition of the service concession asset. Accordingly, such payments do not relate to the liability specified in paragraph AG48. The grantor compensates the operator only to the extent of the usage of the service concession asset, and accounts for such payments as expenses in accordance with IPSAS 1.

Dividing the Arrangement (see paragraphs 27–28)

- AG50. If the operator is compensated for the service concession asset partly by a predetermined series of payments and partly by receiving the right to earn

revenue from third-party use of either the service concession asset or another revenue-generating asset, it is necessary to account separately for each portion of the liability related to the grantor's consideration. In these circumstances, the consideration to the operator is divided into a financial liability portion for the predetermined series of payments and a liability portion for the right granted to the operator to earn revenue from third-party use of the service concession asset or another revenue-generating asset. Each portion of the liability is recognized initially at the fair value of the consideration paid or payable.

Other Liabilities, Commitments, Contingent Liabilities and Contingent Assets (see paragraph 29)

- AG51. Service concession arrangements may include various forms of financial guarantees (e.g., a guarantee, security, or indemnity related to the debt incurred by the operator to finance construction, development, acquisition, or upgrade of a service concession asset), or performance guarantees (e.g., guarantee of minimum revenue streams, including compensation for short-falls).
- AG52. Certain guarantees made by a grantor may meet the definition of a financial guarantee contract. The grantor determines whether guarantees made by the grantor as part of a service concession arrangement meet the definition of a financial guarantee contract and applies IPSAS 28, IPSAS 29, and IPSAS 30 in accounting for the guarantee. Where the guarantee is an insurance contract, the grantor can elect to apply the relevant international or national accounting standard dealing with insurance contracts. See IPSAS 28, paragraphs AG3–AG9 for further guidance.
- AG53. Guarantees and commitments that do not meet the requirements in IPSAS 28 and IPSAS 29 relating to financial guarantee contracts or are not insurance contracts are accounted for in accordance with IPSAS 19.
- AG54. Contingent assets or liabilities may arise from disputes over the terms of the service concession arrangement. Such contingencies are accounted for in accordance with IPSAS 19.

Other Revenues (see paragraph 30)

- AG55. The operator may compensate the grantor for access to the service concession asset by providing the grantor with a series of predetermined inflows of resources, including the following:
 - (a) An upfront payment or a stream of payments;
 - (b) Revenue-sharing provisions;
 - (c) A reduction in a predetermined series of payments the grantor is required to make to the operator; and

- (d) Rent payments for providing the operator access to a revenue-generating asset.

- AG56. When the operator provides an upfront payment, a stream of payments, or other consideration to the grantor for the right to use the service concession asset over the term of the service concession arrangement, the grantor accounts for these payments in accordance with IPSAS 9. The timing of the revenue recognition is determined by the terms and conditions of the service concession arrangement that specify the grantor's obligation to provide the operator with access to the service concession asset.
- AG57. Where the operator provides an upfront payment, a stream of payments, or other consideration to the grantor in addition to the service concession asset, for the right to earn the revenue from third-party use of the service concession asset, or another revenue-generating asset, any portion of the payments received from the operator not earned in the accounting period is recognized as a liability until the conditions for revenue recognition are met.
- AG58. When the conditions for revenue recognition are met, the liability is reduced as the revenue is recognized in accordance with paragraph 30.
- AG59. However, given the varying nature of the types of assets that may be used in service concession arrangements, and the number of years over which the arrangements operate, there may be more appropriate alternative methods for recognizing revenue associated with the inflows specified in the binding arrangement that better reflect the operator's economic consumption of their access to the service concession asset and/or the time value of money. For example, an annuity method that applies a compounding interest factor that more evenly recognizes revenue on a discounted basis, as opposed to on a nominal basis, may be more appropriate for a service concession arrangement with a term extending over several decades.
- AG60. When an upfront payment is received from the operator, the revenue is recognized in a way that best reflects the operator's economic consumption of its access to the service concession asset and/or the time value of money. For example, when the operator is required to pay annual installments over the term of the service concession arrangement, or predetermined sums for specific years, the revenue is recognized over the specified term.
- AG61. For service concession arrangements under which the operator is granted the right to earn revenue from third-party users of the service concession asset, revenue relates to the inflow of economic benefits received as the services are provided and is therefore recognized on the same basis as the liability is reduced. In these cases, the grantor will often negotiate to include a revenue-sharing provision in the arrangement with the operator. Revenue-sharing as part of a service concession arrangement may be based on all revenue earned by the operator, or on revenue above a certain threshold, or

on revenue more than the operator needs to achieve a specified rate of return.

- AG62. The grantor recognizes revenue generated from revenue-sharing provisions in service concession arrangements as it is earned, in accordance with the substance of the relevant agreement, after any contingent event (e.g., the achievement of a revenue threshold) is deemed to have occurred. The grantor applies IPSAS 19 to determine when the contingent event has occurred.
- AG63. A reduction in the future predetermined series of payments the grantor would otherwise be required to make to the operator provides the grantor with upfront non-cash consideration. Such revenue is recognized as the liability is reduced.
- AG64. When the operator pays a nominal rent for access to a revenue-generating asset, the rental revenue is recognized in accordance with IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)*.

Presentation and Disclosure (see paragraphs 31–33)

- AG65. Disclosures relating to various aspects of service concession arrangements may be addressed in existing Standards. This Standard addresses only the additional disclosures relating to service concession arrangements. Where the accounting for a particular aspect of a service concession arrangement is addressed in another Standard, the grantor follows the disclosure requirements of that Standard in addition to those set out in paragraph 32.
- AG66. IPSAS 1 requires finance costs to be presented separately in the statement of financial performance. The finance charge determined in accordance with paragraph 21 is included in this item.
- AG67. In addition to the disclosures outlined in paragraphs 31–33, the grantor also applies the relevant presentation and disclosure requirements in other IPSASs as they pertain to assets, liabilities, revenues, and expenses recognized under this Standard.

Transition (see paragraphs 34–35)

- AG68. Where the grantor has not previously recognized service concession assets, it may elect to under paragraph 35(b) to recognize and measure service concession assets and related liabilities prospectively, using deemed cost. Deemed cost is determined at the beginning of the earliest period for which comparative information is presented in the financial statements.
- AG69. Deemed cost for service concession assets should be determined using the following measurement bases:
 - (a) For property, plant, and equipment – fair value, or depreciated replacement cost as a means of estimating fair value where there is

no market. IPSAS 17 allows revaluation using fair value or depreciated replacement cost (see IPSAS 17, paragraphs 46–48); and

- (b) For intangible assets – fair value. IPSAS 31 only allows fair value for revaluation, thus the deemed cost is limited to fair value.

AG70. The related liability should be determined using the following approaches:

- (a) For the liability under the financial liability model, the remaining contractual cash flows specified in the binding arrangement and the rate described in paragraphs AG41–AG46.
- (b) For the liability under the grant of a right to the operator model, the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement.

AG71. Depreciation or amortization is based on that deemed cost and starts from the date for which the entity established the deemed cost.

Use of Deemed Cost under the Financial Liability Model

AG72. Where the grantor uses deemed cost under the financial liability model, it measures:

- (a) The service concession asset at fair value (see paragraph 11); and
- (b) The financial liability using the remaining contractual cash flows specified in the binding arrangement and the rate described in paragraphs AG41–AG46 at the beginning of the earliest period for which comparative information is presented in the financial statements.

Any difference between the value of the asset and the financial liability is recognized directly in net assets/equity. If the entity chooses as its accounting policy the revaluation model in IPSAS 17 or IPSAS 31, this difference is included in any revaluation surplus.

Use of Deemed Cost under the Grant of a Right to the Operator Model

AG73. Where the grantor uses deemed cost under the grant of a right to the operator model, it measures:

- (a) The service concession asset at fair value (see paragraph 11); and
- (b) The liability representing the unearned portion of any revenue arising from the receipt of the service concession asset. This amount should be determined as the fair value of the asset less any financial liabilities, adjusted to reflect the remaining period of the service concession arrangement.

Amendments to Other IPSASs

IPSAS 5, *Borrowing Costs*

Paragraph 6 is amended as follows:

Borrowing Costs

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

Effective Date

A new paragraph is inserted after paragraph 42 as follows:

42A. Paragraph 6 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 5, 7 and 107C of IPSAS 17, the amendments to paragraphs 2 and 125A of IPSAS 29 and the amendments to paragraphs 6 and 132A of IPSAS 31.

IPSAS 13, *Leases*

Paragraphs 25–27 are amended as follows:

Leases and Other Contracts

25. A contract may consist solely of an agreement to lease an asset. However, a lease may also be one element in a broader set of agreements with private sector entities to construct, own, operate and/or transfer assets. Public sector entities often enter into such agreements, particularly in relation to long-lived physical assets and infrastructure assets. ~~For example, a public sector entity~~

~~may construct a tollway. It may then lease the tollway to a private sector entity as part of an arrangement whereby the private sector entity agrees to:~~

- ~~(a) Lease the tollway for an extended period of time (with or without an option to purchase the facility);~~
- ~~(b) Operate the tollway; and~~
- ~~(c) Fulfill extensive maintenance requirements, including regular upgrading of both the road surface and the traffic control technology.~~

Other agreements may involve a public sector entity leasing infrastructure from the private sector. The entity determines whether the arrangement is a service concession arrangement, as defined in IPSAS 32, *Service Concession Arrangements: Grantor*.

26. Where an arrangement does not meet the conditions for recognition of a service concession asset in accordance with IPSAS 32 and the arrangement contains an identifiable operating lease or finance lease as defined in this Standard, the provisions of this Standard are applied in accounting for the lease component of the arrangement.
27. Public sector entities may also enter a variety of agreements for the provision of goods and/or services, which necessarily involve the use of dedicated assets. In some of these agreements, it may not be clear whether ~~or not~~ a service concession arrangement as defined in IPSAS 32 or a lease, as defined by this Standard, has arisen. In these cases, professional judgment is exercised, and if a lease has arisen this standard is applied; if a lease has not arisen, entities account for those agreements by applying the provisions of other relevant IPSASs, or in the absence thereof, other relevant international and/or national accounting standards.

Effective Date

A new paragraph is inserted after paragraph 85A as follows:

85B. Paragraphs 25, 26 and 27 were amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 5, 7 and 107C of IPSAS 17, the amendments to paragraphs 2 and 125A of IPSAS 29 and the amendments to paragraphs 6 and 132A of IPSAS 31.

IPSAS 17, *Property, Plant, and Equipment*

Paragraph 5 is amended as follows:

Scope

5. This Standard applies to property, plant, and equipment including:
 - (a) Specialist military equipment; ~~and~~
 - (b) Infrastructure assets; ~~and~~
 - (c) Service concession arrangement assets after initial recognition and measurement in accordance with IPSAS 32, *Service Concession Arrangements: Grantor*.

Paragraph 7 is amended as follows:

7. Other IPSASs may require recognition of an item of property, plant, and equipment based on an approach different from that in this Standard. For example, IPSAS 13, *Leases* requires an entity to evaluate its recognition of an item of leased property, plant, and equipment on the basis of the transfer of risks and rewards. IPSAS 32 requires an entity to evaluate the recognition of an item of property, plant, and equipment used in a service concession arrangement on the basis of control of the asset. However, in such cases other aspects of the accounting treatment for these assets, including depreciation, are prescribed by this Standard.

Effective Date

A new paragraph is inserted after paragraph 107B as follows:

107C. Paragraphs 5 and 7 were amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply those amendments for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 2 and 125A of IPSAS 29 and the amendments to paragraphs 6 and 132A of IPSAS 31.

IPSAS 29, *Financial Instruments: Recognition and Measurement*

Paragraph 2 is amended as follows:

2. This Standard shall be applied by all entities to all types of financial instruments, except: ...
 - (k) Rights and obligations under service concession arrangements to which IPSAS 32, *Service Concession Assets: Grantor* applies. However, financial liabilities recognized by a grantor under the financial liability model are subject to the derecognition provisions

of this Standard (see paragraphs 41–44 and Appendix A paragraphs AG72–AG80).

Effective Date

A new paragraph is inserted after paragraph 125 as follows:

125A. Paragraph 2 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendment for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 5, 7 and 107C of IPSAS 17 and the amendments to paragraphs 6 and 132A of IPSAS 31.

IPSAS 31, *Intangible Assets*

Paragraph 6 is amended as follows:

Scope

6. If another IPSAS prescribes the accounting for a specific type of intangible asset, an entity applies that IPSAS instead of this Standard. For example, this Standard does not apply to:
 - (a) Intangible assets held by an entity for sale in the ordinary course of operations (see IPSAS 11, *Construction Contracts*, and IPSAS 12, *Inventories*);
 - (b) Leases that are within the scope of IPSAS 13, *Leases*;
 - (c) Assets arising from employee benefits (see IPSAS 25, *Employee Benefits*); ~~and~~
 - (d) Financial assets as defined in IPSAS 28. The recognition and measurement of some financial assets are covered by IPSAS 6, *Consolidated and Separate Financial Statements*, IPSAS 7, *Investments in Associates*, and IPSAS 8, *Interests in Joint Ventures*; ~~and~~
 - (e) Recognition and initial measurement of service concession assets that are within the scope of IPSAS 32, *Service Concession Assets: Grantor*. However, this Standard applies to the subsequent measurement and disclosure of such assets.

Effective Date

A new paragraph is inserted after paragraph 132 as follows:

132A. Paragraph 6 was amended by IPSAS 32, *Service Concession Arrangements: Grantor* issued in October 2011. An entity shall apply that amendment for annual financial statements covering periods beginning on or after January 1, 2014. Earlier application is encouraged. If an entity applies the amendments for a period beginning before January 1, 2014, it shall disclose that fact and at the same time apply IPSAS 32, the amendments to paragraphs 6 and 42A of IPSAS 5, the amendments to paragraphs 25–27 and 85B of IPSAS 13, the amendments to paragraphs 5, 7 and 107C of IPSAS 17 and the amendments to paragraphs 2 and 125A of IPSAS 29.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 32.

Objective

BC1. In the absence of an International Public Sector Accounting Standard dealing with service concession arrangements, public sector entities are directed, in IPSAS 1, *Presentation of Financial Statements* to look to other international or national accounting standards. In the case of arrangements involving private sector participation, they would try to apply the principles in Interpretation 12 of the International Accounting Standards Board's International Financial Reporting Interpretations Committee (IFRIC 12), *Service Concession Arrangements*. However, IFRIC 12 addresses accounting by the operator, and does not, therefore, provide guidance for the grantor. The IPSASB believes this Standard will promote consistency and comparability in how service concession arrangements are reported by public sector entities.

Scope

BC2. After considering the various types of arrangements involving public and private sector entities identified in the development of the March 2008 Consultation Paper, *Accounting and Financial Reporting for Service Concession Arrangements*, the IPSASB concluded that the scope of this Standard should be the mirror of IFRIC 12, in particular, the criteria under which the grantor recognizes a service concession asset (see paragraphs BC11–BC16). The rationale for this decision is that this approach would require both parties to the same arrangement to apply the same principles in determining which party should recognize the asset used in a service concession arrangement. Thus, arrangements in which the criteria for recognition of a service concession asset in paragraph 9 (or paragraph 10 for a whole-of-life asset) are not satisfied, are outside the scope of this IPSAS. The IPSASB considers that this approach minimizes the possibility for an asset to be accounted for by both of the parties, or by neither party.

BC3. The IPSASB recognized that the Standard should provide Implementation Guidance on the relevant IPSASs that apply to arrangements outside the scope of the Standard. The Implementation Guidance contains a flowchart illustrating the application of this Standard as well as a table of references to relevant IPSASs for the other types of arrangements that are outside the scope of this Standard.

BC4. The IPSASB concluded that it was important to provide guidance on accounting for the consideration given by the grantor to the operator for the service concession asset. The consideration may give the operator rights to a determinable series of payments of cash or cash equivalents or a right to earn revenue from third-party users of the service concession asset or another

revenue-generating asset for its use, or a combination of both types of consideration. Each type of consideration results in specific accounting issues on which the IPSASB has provided guidance to facilitate consistent application of the Standard.

- BC5. The IPSASB also concluded that guidance was necessary on applying the general revenue recognition principles in IPSAS 9, *Revenue from Exchange Transactions* to service concession arrangements because of the unique features of some service concession arrangements (e.g., revenue-sharing provisions).
- BC6. This Standard does not specify the accounting by operators, because it is addressed in IFRIC 12. In many cases the operator is a private sector entity, and IPSASs are not designed to apply to private sector entities. The operator or the grantor may also be a Government Business Enterprise (GBE). IPSASs are not designed to apply to GBEs. International Financial Reporting Standards (IFRSs) apply to private sector entities and GBEs.
- BC7. Some respondents to ED 43 suggested that the scope of the proposed Standard should be extended to include public-to-public service concession arrangements. The IPSASB noted that addressing the accounting for such arrangements was not the primary purpose of the project which was to address the cases when the grantor is a public sector entity that follows accrual IPSASs. The IPSASB noted that application of this Standard by analogy would be appropriate under paragraphs 12–15 of IPSAS 3, *Accounting Policies, Changes in Accounting Estimates and Errors* for the public sector grantor and that relevant international or national accounting standard dealing with service concession arrangements may be applied by the public sector operator

Definitions

- BC8. ED 43 did not provide definitions because IFRIC 12 did not do so. Accordingly, ED 43 provided guidance on certain terminology. Respondents to ED 43 proposed that, because this is a Standard and not an Interpretation, it was important to include definitions for consistency in application of the Standard. The IPSASB agreed that this Standard should include definitions.
- BC9. The IPSASB agreed not to use the term “infrastructure” to refer to the asset used in a service concession arrangement, even though IFRIC 12 uses the term. The IPSASB noted that the term is used in IPSASs in ways that may not be fully compatible with this Standard. Further, the term has a prescribed meaning in some jurisdictions that differs from that used in IFRIC 12. To ensure clarity that the asset referred to is the one recognized on the basis of the conditions for recognition in paragraph 9 of this Standard (or paragraph 10 for a whole-of-life asset), the asset in this Standard is referred to as the

“service concession asset”. This term is intended to cover the same types of assets as envisaged in IFRIC 12.

BC10. The term “binding arrangement” had not been defined previously, but has been used in other IPSASs to describe arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract. The IPSASB concluded that for the purposes of this Standard, this term should be defined to ensure consistent application of the Standard.

Recognition of a Service Concession Asset

BC11. The main accounting issue in service concession arrangements is whether the grantor should recognize a service concession asset.

BC12. The IPSASB considered the merits of the risks and rewards and the control-based approach to assess whether the grantor should recognize the asset. The risks and rewards approach focuses on the economic aspects of the terms and conditions in the arrangement. The IPSASB did not believe this focus to be appropriate for service concession arrangements because the primary purpose of a service concession asset, from the grantor’s point of view, is to provide specified public services on behalf of the grantor using a service concession asset, and not to provide economic benefits such as revenue generated by such assets (e.g., from user fees). Thus, the service potential of the asset accrues to the grantor. Economic benefits are only likely to arise from a service concession arrangement in circumstances where the operator is granted the right to earn revenue from third-party users, of either the service concession asset or another revenue-generating asset. A control-based approach focuses on control over the economic benefits and the service potential of the service concession asset.

BC13. As it is often the case that service concession arrangements are entered into for the sharing of risks between the grantor and the operator, the IPSASB also questioned whether sufficiently objective criteria could be established for assessing risks and rewards to enable consistent results to be determined. In addition, weighting of various risks and rewards was seen to be problematic. The IPSASB concluded, therefore, that the risks and rewards approach is inappropriate.

BC14. The IPSASB also considered whether a rights and obligations approach was appropriate. Although such an approach could have conceptual merit, the IPSASB believes that it would represent a significant change in the accounting and financial reporting of assets and liabilities for public sector entities that could have implications beyond service concession arrangements. Given the IPSASB’s decision to complement IFRIC 12, which uses a control-based approach, the IPSASB agreed that a rights and obligations approach was not appropriate for this Standard.

BC15. The IPSASB concluded that a control-based approach was the most effective means to determine whether the grantor should recognize the asset. The IPSASB concluded that if a control-based approach is used, it should be consistent with IFRIC 12, for the same reasons cited in paragraph BC2. Accordingly, this Standard addresses only arrangements in which the grantor (a) controls or regulates the services provided by the operator, and (b) controls any significant residual interest in the service concession asset at the end of the term of the arrangement. Consistent with IFRIC 12, in the case of whole-of-life assets, only condition (a) must be met for recognition of a service concession asset. The IPSASB concluded that it was important to stress that a service concession arrangement is a binding arrangement. Accordingly, the assessment of whether a service concession asset should be recognized is made on the basis of all of the facts and circumstances of the arrangement.

BC16. Paragraph 9(a) of this Standard is consistent with paragraph 5 of IFRIC 12. It is intended to apply only to the regulation that is specific to the service concession arrangement, and not to the broad understanding of public sector regulatory powers from the grantor's point of view. The regulation referred to in paragraph 9(a) of this Standard is either by contract or through a regulator. Guidance is provided in paragraph AG6 on applying the term "regulates" in paragraph 9(a) to determine whether the grantor should recognize a service concession asset. Some respondents to ED 43 asserted that providing such additional guidance creates an asymmetry with IFRIC 12, as there is no additional guidance on the meaning of this term. The IPSASB considers the additional guidance provided in paragraph AG6 is necessary to ensure symmetry exists between the public sector grantor's and the private sector operator's application of the "regulates" criterion in determining whether to recognize the service concession asset, as the public sector may have considered the term in the context of the broad regulatory powers of governments.

Recognition of a Liability

BC17. ED 43 described two circumstances that may give rise to a liability when the grantor recognizes a service concession asset, based on the nature of the consideration due to the operator in exchange for the service concession asset.

BC18. ED 43 proposed that when the grantor recognizes a service concession asset, a liability shall also be recognized. The ED noted that this liability may be any combination of a financial liability and a performance obligation. ED 43 proposed that a financial liability occurs when the grantor has a determinable series of cash payments of cash or cash equivalents to make to the operator and a performance obligation occurs when the grantor compensates the operator by granting the operator the right to charge users of the service concession asset or by granting the operator access to another revenue-generating asset for its use. ED 43 proposed that the grantor account for the

performance obligation in accordance with IPSAS 19, *Provisions, Contingent Liabilities and Contingent Assets*.

BC19. Respondents to ED 43 sought clarification on this issue, particularly with respect to the “performance obligation” identified in ED 43. Respondents’ concerns are summarized below.

- (a) The right to charge users of the service concession asset or by granting the operator access to another revenue-generating asset was seen by some respondents as independent of the compensation for the asset. These respondents highlighted that the requirement to provide access is a feature of most service concession arrangements, and if this is to be recognized, such recognition should not be dependent on the non-occurrence of a payment stream from the grantor to the operator.
- (b) While being described as a performance obligation, there is no obligation for an outflow of economic resources from the grantor in future periods. These respondents therefore question whether a liability as defined in IPSAS 1, or a provision as defined in IPSAS 19 could be fairly represented to exist.

BC20. In addition, a number of other respondents, possibly as a result of the above concerns, requested clarification of the meaning of “performance obligation” in the ED. A few of these respondents queried whether the substance of the nature of this “balancing item” was deferred revenue.

BC21. The IPSASB agreed that clarification of this issue was required. The IPSASB noted that using the term “performance obligation” could give rise to confusion because it is used in IPSAS 23, *Revenue from Non-Exchange Transactions (Taxes and Transfers)* in relation to non-exchange transactions. The IPSASB noted that a service concession arrangement is an exchange transaction rather than a non-exchange transaction and therefore it would be preferable not to use the term performance obligation in relation to exchange transactions.

BC22. In IFRIC 12, when the operator does not control the service concession asset, the operator recognizes either a financial asset, or an intangible asset, depending on which party bears the demand risk. The IPSASB agreed that, to maintain symmetry with IFRIC 12, the same approach should be adopted for the grantor. Thus, two models are identified for accounting for the credit when the grantor recognizes a service concession asset in accordance with this Standard: the financial liability model, and the grant of a right to the operator model (which replaces the “performance obligation”).

BC23. The IPSASB’s decision to amend the terminology used in ED 43 from “performance obligation” to the Standard’s use of “liability” does not change the grantor’s accounting treatment of a service concession arrangement from that proposed in ED 43.

The Financial Liability Model

BC24. Where the grantor compensates the operator by the delivery of cash or another financial asset in exchange for its control of a service concession asset, IFRIC 12 classifies this type of arrangement as the “financial asset model” because the operator receives a financial asset. This Standard refers to this type of arrangement as the “financial liability model” because the grantor has a financial liability.

BC25. A financial liability arises in cases when the grantor is obligated to make a determinable series of payments to the operator because the grantor has an obligation as a result of the binding arrangement to deliver cash or another financial asset to another entity (the operator). The IPSASB concluded further that when there is a determinable series of payments of cash or cash equivalents, the payments should be allocated as a reduction of the liability, an imputed finance charge, and charges for services provided by the operator under the service concession arrangement.

BC26. Service concession arrangements are concluded by way of a binding arrangement, which may include contracts or similar arrangements that confer similar rights and obligations on the parties as if they were in the form of a contract. The IPSASB concluded that, if similar arrangements exist that confer the same rights and obligations on either party as if they were in the form of a contract, IPSAS 28, *Financial Instruments: Presentation*, IPSAS 29, *Financial Instruments: Recognition and Measurement*, and IPSAS 30, *Financial Instruments: Disclosures* should be applied by analogy to such arrangements.

BC27. In considering a departure from this aspect of IFRIC 12, the IPSASB noted that the main features of IFRIC 12 that were the subject of the “mirror” approach to developing this Standard were limited to the scope of the arrangements to be included and the recognition and disclosure requirements.

BC28. IFRIC 12 requires the financial asset to be accounted for in accordance with the IFRS on financial instruments. This Standard provides guidance for determining the interest rate to be used to determine the finance charge under the financial liability model. The IPSASB considered the grantor ordinarily would not have sufficient information to determine a market rate. Accordingly, the guidance requires the operator’s cost of capital to be used, if that is practicable to determine. It also permits other rates to be used appropriate to the specific terms and conditions of the service concession arrangement.

Grant of a Right to the Operator Model

BC29. In responding to the issues raised by respondents to ED 43, the IPSASB reconsidered the nature of the consideration given by the grantor for the service concession asset where the operator recoups the price of the asset from

earning revenue from third-party users of the service concession asset or another revenue-generating asset. The IPSASB noted that in this situation, the cash consideration for the service concession asset is not being met by the grantor but by users of the service concession asset or other revenue-generating asset. The economic substance of this arrangement provides an increase in net assets to the grantor, and therefore revenue accrues and should be recognized. As the service concession arrangement is an exchange transaction, the Board referred to IPSAS 9 when considering the nature of the revenue and the timing of the recognition of that revenue.

BC30. Where the operator bears the demand risk, the grantor compensates the operator by the grant of a right (e.g., a licence) to charge users of the public service related to the service concession asset or of another revenue-generating asset. The grantor provides the operator access to the asset in order for the operator to be compensated for construction, development, acquisition, or upgrade of the service concession asset. IFRIC 12 classifies this type of arrangement as the “intangible asset model.” This Standard refers to this type of arrangement as the “grant of a right to the operator model.”

BC31. The IPSASB therefore considered whether the credit should be accounted for as a liability, as a direct increase to net assets/equity, or as revenue.

BC32. It was agreed that, in this circumstance, the grantor does not have a liability because the service concession arrangement is an exchange of assets, with the service concession asset being obtained by the grantor in exchange for a transfer of rights to the operator to earn revenue from third-party users of the asset over the period of the service concession arrangement.

BC33. Some respondents to ED 43 indicated that the credit should be treated as net assets/equity, consistent with IPSAS 1, which defines net assets/equity as the residual interest in the assets of the entity after deducting all its liabilities. IPSAS 1 envisages four components of net assets/equity. Those components include:

- (a) Contributed capital, being the cumulative total at the reporting date of contributions from owners, less distributions to owners;
- (b) Accumulated surpluses or deficits;
- (c) Reserves, including a description of the nature and purpose of each reserve within net assets/equity; and
- (d) Minority interests.

BC34. The IPSASB concluded that the credit did not represent a direct increase in the grantor’s net assets/equity because the credit is not one of the components of net assets/equity identified in paragraph BC33 for the reasons noted below:

- (a) Contributions from owners are defined as “future economic benefits or service potential that has been contributed to the entity by parties

external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which: (a) Conveys entitlement both to (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or (b) Can be sold, exchanged, transferred, or redeemed.” The credit related to the recognition of a service concession asset does not meet this definition because the operator has not made a contribution to the grantor that results in a financial interest in the entity by the operator as envisaged by IPSAS 1.

- (b) Accumulated surplus/deficit is an accumulation of an entity’s surpluses and deficits. The credit related to recognition of a service concession asset represents an individual transaction and not an accumulation.
- (c) Reserves generally arise from items recognized directly in net assets/equity from specific requirements in IPSASs, and may include, for example, gains and losses on revaluation of assets (e.g., property, plant, and equipment, investments). The credit related to the recognition or reclassification of a service concession asset does not represent a gain or loss specified to be directly recognized in net/assets equity because it involves an exchange transaction and not a revaluation of an existing asset of the grantor. Existing assets of the grantor, when used in a service concession arrangement and continue to meet the control criteria in this Standard, are reclassified, thus no revaluation is done.
- (d) A minority interest is defined as “that portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly, through controlled entities, by the controlling entity.” A minority interest may arise, for example, when at the whole-of-government level, the economic entity includes a GBE that has been partly privatized. Accordingly, there may be private shareholders who have a financial interest in the net assets/equity of the entity. The credit related to the recognition of a service concession asset does not meet this definition because operator does not have such a financial interest in the grantor.

BC35. The IPSASB agreed that the credit represents revenue. As a service concession arrangement is an exchange transaction, the IPSASB referred to IPSAS 9 when considering the nature of the revenue and the timing of the recognition of that revenue. In accordance with IPSAS 9, when goods are sold or services are rendered in exchange for dissimilar goods or services, the exchange is regarded as a transaction that generates revenue as it results in an increase in the net assets of the grantor. In this situation, the grantor has

received a service concession asset in exchange for granting a right (a license) to the operator to charge the third party users of the public service that it provides on the grantor's behalf. The service concession asset recognized by the grantor and the right (intangible asset) recognized by the operator are dissimilar. However, until the criteria for recognition of revenue have been satisfied, the credit is recognized as a liability.

BC36. The IPSASB noted that, in this situation, there is no cash inflow to equal the revenue recognized. This result is consistent with IPSAS 9 in which an entity provides goods or services in exchange for another dissimilar asset that is subsequently used to generate cash revenues.

BC37. The revenue is measured at the fair value of the goods or services received, adjusted by the amount of any cash or cash equivalents transferred. When the fair value of the goods or services received cannot be measured reliably, the revenue is measured at the fair value of the goods or services given up, adjusted by the amount of any cash or cash equivalents transferred.

BC38. IPSAS 9 identifies three types of transaction that give rise to revenue: the rendering of services, the sale of goods (or other assets) and revenue arising from the use by others of the entity's assets, yielding interest, royalties, and dividends. In considering the nature of the revenue, the IPSASB considered these types of transactions separately.

BC39. The IPSASB considered the approaches to revenue recognition set out in IPSAS 9 in relation to the "grant of a right to the operator" model and concluded that none of those scenarios fully met the circumstances of this model. Nevertheless, the IPSASB noted that the timing of revenue recognition under each of them is over the term of the arrangement, rather than immediately. The IPSASB determined that, by analogy, such a pattern of revenue recognition was also appropriate for recognizing the revenue arising from the liability related to this model. As a result, until the criteria for recognition of revenue have been satisfied, the credit is recognized as a liability.

BC40. The IPSASB considered whether the grantor should recognize the operating expenses in the circumstances described in paragraph BC30 relating to the grant of a right to the operator model. The IPSASB noted that the grantor's liability recognized relates solely to the service concession asset received by the grantor. If the service expenses were recognized, the grantor would also have to recognize annually imputed revenue equal to the annual expense. The IPSASB did not believe this accounting would provide useful information, because revenue and an expense of equal amounts would be recognized annually. The IPSASB noted further that reliable information about the operator's expenses may not be available in any case. The IPSASB therefore concluded that the grantor should not recognize operating expenses associated

with the service concession arrangement in the circumstances described in paragraph BC30.

Accounting Issues Addressed in Other IPSASs

BC41. Because of the complexity of many service concession arrangements, there may be additional accounting issues related to certain terms in the contract, or a similar binding arrangement (e.g., revenues, expenses, guarantees, and contingencies). The IPSASB agreed that it was not necessary to repeat such existing guidance in this Standard. Accordingly, when an existing IPSAS specifies the accounting and reporting for a component of a service concession arrangement, that IPSAS is referred to in this Standard and no additional guidance is provided. However, the IPSASB noted some cases (e.g., revenue recognition), when the application of such IPSASs would be difficult given certain unique features in service concession arrangements. To ensure consistent implementation of this Standard, the IPSASB provided specific guidance on how the principles in the other IPSAS would be applied.

Transition

BC42. This Standard requires an entity that has previously recognized service concession assets and related liabilities, revenues, and expenses to apply this Standard retrospectively in accordance with IPSAS 3. The Standard also requires an entity that has not previously recognized service concession assets and related liabilities, revenues, and expenses and uses the accrual basis of accounting to apply this Standard either retrospectively or prospectively using deemed cost from the beginning of the earliest period for which comparative information is presented in the financial statements.

BC43. The general requirement in IPSAS 3 is that the changes should be accounted for retrospectively, except to the extent that retrospective application would be impracticable. The IPSASB noted that there are two aspects to retrospective determination: reclassification and remeasurement. The IPSASB took the view that it will usually be practicable to determine retrospectively the appropriate classification of all amounts previously included in a grantor's statement of financial position, but that retrospective remeasurement of service concession assets might not always be practicable, particularly if an entity has not previously recognized service concession assets and related liabilities, revenues, and expenses.

BC44. The IPSASB noted that, when retrospective restatement is not practicable, IPSAS 3 requires prospective application from the earliest practicable date, which could be the start of the current reporting period.

BC45. The transitional provisions in this Standard for entities that have not previously recognized service concession assets were amended from ED 43 because some respondents to ED 43 questioned why the general requirement

in IPSAS 3 is not also appropriate for an entity that has not previously recognized service concession arrangements. ED 43 required prospective application in such cases, but permitted retrospective application.

BC46. When developing ED 43 the IPSASB had concerns relating to the practicality of determining the measurement of a service concession asset, and considered that this could result in inconsistent treatment of arrangements entered into in the past. This was a similar issue to that which arose in finalizing IPSAS 31, *Intangible Assets*. On that basis, the IPSASB considered it appropriate to propose transitional provisions in ED 43 that were consistent with those in IPSAS 31.

BC47. However, the IPSASB noted that the circumstances surrounding intangible assets differ from those in service concession arrangements. Notably, service concession arrangements generally involve long-term binding arrangements for which information required to develop fair value and cost information would likely be more readily available than it is for intangible assets acquired or developed in the past, even in cases where an entity had not previously recognized service concession assets.

BC48. The IPSASB did however acknowledge that because many of these arrangements may have been entered into some time ago, it may be difficult to apply full retrospective application. As a result, the IPSASB considered that a “deemed cost” could be used to recognize and measure service concession assets.

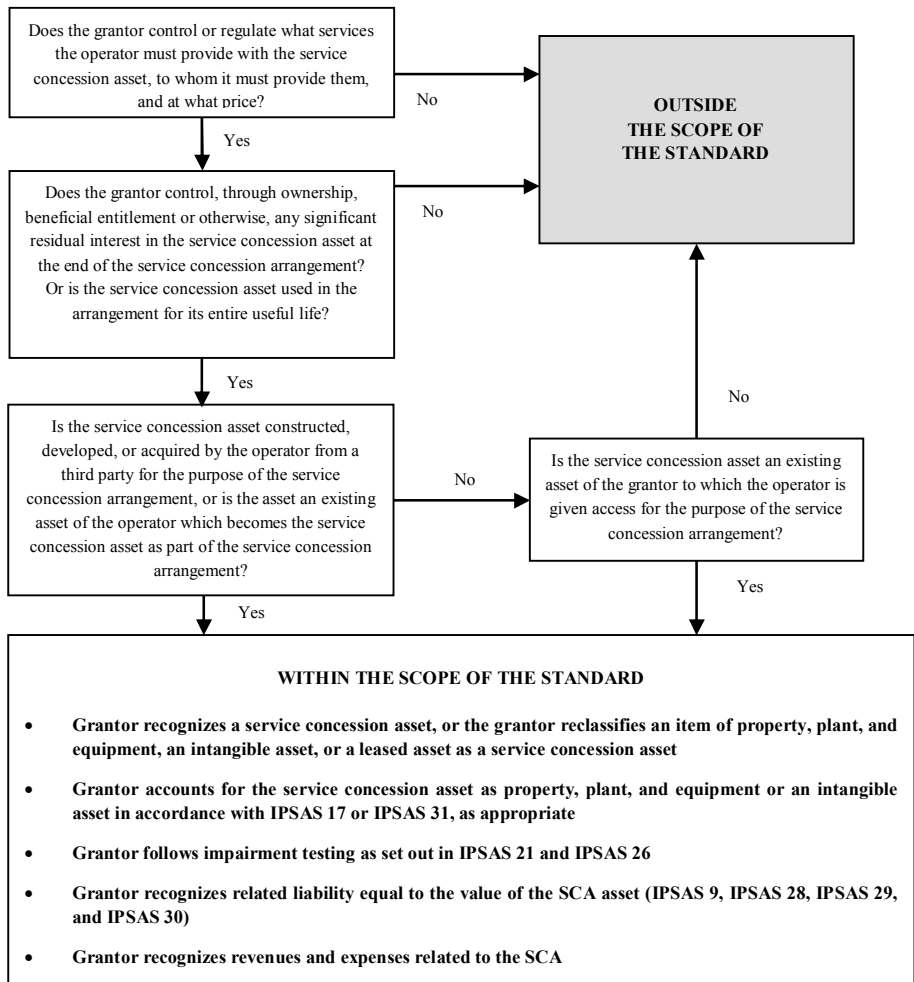
Implementation Guidance

This guidance accompanies, but is not part of, IPSAS 32.

IG1. The purpose of this Implementation Guidance is to illustrate certain aspects of the requirements of IPSAS 32.

Accounting Framework for Service Concession Arrangements

IG2. The diagram below summarizes the accounting for service concession arrangements established by IPSAS 32.



References to IPSASs that Apply to Typical Types of Arrangements Involving an Asset Combined with Provision of a Service

IG3. The table sets out the typical types of arrangements for private sector participation in the provision of public sector services and provides references to IPSASs that apply to those arrangements. The list of arrangements types is not exhaustive. The purpose of the table is to highlight the continuum of arrangements. It is not the IPSASB's intention to convey the impression that bright lines exist between the accounting requirements for various types of arrangements.

IG4. Shaded text shows arrangements within the scope of IPSAS 32.

Category	Lessee	Service provider			Owner	
Typical arrangement types	Lease (e.g., operator leases asset from grantor)	Service and/or maintenance contract (specific tasks e.g., debt collection, facility management)	Rehabilitate-operate-transfer	Build-operate-transfer	Build-own-operate	100% Divestment/ Privatization/ Corporation
Asset ownership	Grantor			Operator		
Capital investment	Grantor		Operator			
Demand risk	Shared	Grantor	Grantor and/or Operator		Operator	
Typical duration	8–20 years	1–5 years	25–30 years		Indefinite (or may be limited by binding arrangement or license)	
Residual interest	Grantor			Operator		
Relevant IPSASs	IPSAS 13	IPSAS 1	This IPSAS/IPSAS 17/ IPSAS 31		IPSAS 17/IPSAS 31 (derecognition) IPSAS 9 (revenue recognition)	

Illustrative Examples

These examples accompany, but are not part of, IPSAS 32.

- IE1. These examples deal with only three of many possible types of service concession arrangements. Their purpose is to illustrate the accounting treatment for some features that are commonly found in practice. To make the illustrations as clear as possible, it has been assumed that the term of the service concession arrangement is only ten years and that the operator's annual receipts are constant over that period. In practice, terms may be much longer and annual revenues may increase with time.

Arrangement Terms (Common to All Three Examples)

- IE2. In these examples, monetary amounts are denominated in "currency units" (CU).
- IE3. These terms are common to the three examples that follow:
- IE4. The terms of the arrangement require an operator to construct a road—completing construction within two years—and maintain and operate the road to a specified standard for eight years (i.e., years 3–10). The arrangement is within the scope of this Standard and the road meets the conditions for recognition of a service concession asset in paragraph 9 (or paragraph 10 for a whole-of-life asset).
- IE5. The terms of the arrangement also require the operator to resurface the road when the original surface has deteriorated below a specified condition. The operator estimates that it will have to undertake the resurfacing at the end of year 8 at a fair value of CU110. The compensation to the operator for this service is included in the predetermined series of payments and/or the revenue the operator has the right to earn from the service concession asset or another revenue-generating asset granted to the operator by the grantor.
- IE6. It is assumed that the original road surface is a separate component of the service concession asset and meets the criteria for recognition specified in IPSAS 17 when the service concession asset is initially recognized. It is further assumed that there is sufficient certainty regarding the timing and amount of the resurfacing work for it to be recognized as a separate component when the resurfacing occurs.² It is assumed that the expected cost of the resurfacing can be used to estimate the initial cost of the surface layers recognized as a separate component of the service concession asset. The road surface is therefore recognized as a separate component of the initial fair value of the service concession asset and measured at the

² If this was not the case (e.g., where the operator might resurface in future, or might incur additional maintenance over the period of the service concession arrangement), it might not be appropriate to recognize a component.

estimated fair value of the resurfacing and depreciated over years 3–8. This depreciation period is shorter than that for the road base, and takes into account that resurfacing would ordinarily occur over six years, rather than 25 years. During the construction phase, it is assumed that only the road base is constructed in year 1, and that the road only becomes ready to use at the end of year 2.

- IE7. Recognition of the replacement component of the road surface as a separate component of the service concession asset in year 8 also results in an increase in the liability recognized by the grantor. Where the liability relates to the grant of a right to the operator model, additional revenue in respect of this increase is recognized evenly over the term of the arrangement. However, if the expenditure represented an improvement in service potential such as a new traffic lane rather than restoration to original service capability then it would be appropriate to instead recognize revenue relevant to that improvement only once it has occurred.
- IE8. At the beginning of year 3, the total fair value of the road is CU1,050, comprised of CU940 related to the construction of the base layers and CU110 related to construction of the surface layers. The fair value of the surface layers is used to estimate the fair value of the resurfacing (which is treated as a replacement component in accordance with IPSAS 17). The estimated life of surface layers (i.e., six years) is also used to estimate the depreciation of the replacement component in years 9 and 10. The total initial fair value of the road is lower than the present value of the series of predetermined payments pertaining to the asset, where applicable.
- IE9. The road base has an economic life of 25 years. Annual depreciation is taken by the grantor on a straight-line basis. It is therefore CU38 ($940/25$) for the base layers. The surface layers are depreciated over 6 years (years 3–8 for the original component, and starting in year 9 for the replacement component). Annual depreciation related to the surface layers is CU18 ($CU110/6$). There is no impairment in the value of the road over the term of the service concession arrangement.
- IE10. The operator's cost of capital is not practicable to determine. The rate implicit in the service concession arrangement specific to the asset is 6.18%.
- IE11. It is assumed that all cash flows take place at the end of the year.
- IE12. It is assumed that the time value of money is not significant. Paragraph AG59 provides guidance on methods that may be appropriate where the time value of money is significant.
- IE13. At the end of year 10, the arrangement will end. At the end of the arrangement, the operator will transfer the operation of the road to the grantor.

- IE14. The total compensation to the operator under each of the three examples is inclusive of each of the components of the service concession arrangement and reflects the fair values for each of the services, which are set out in Exhibit 1.
- IE15. The grantor's accounting policy for property, plant, and equipment is to recognize such assets using the cost model specified in IPSAS 17.

**Exhibit 1: Fair Values of the Components of the Arrangement
(Currency Units)**

Contact Component	Fair Value
Road – base layers	940
Road – original surface layers	110
Total FV of road	1,050
Annual service component	12
Effective interest rate	6.18%

Example 1: The Grantor makes a Predetermined Series of Payments to the Operator

Additional Terms

- IE16. The terms of the arrangement require the grantor to pay the operator CU200 per year in years 3–10 for making the road available to the public. The total consideration (payment of CU200 in each of years 3–10) reflects the fair values for each of the services indicated in Exhibit 1. These payments are intended to cover the cost of constructing the road, annual operating costs of CU12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of CU110.

Financial Statement Impact

- IE17. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognized as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is taken annually (CU56, comprised of CU38 for the base layers and CU18 for the surface layers), starting from year 3.
- IE18. The grantor initially recognizes a financial liability at fair value equal to the fair value of the asset under construction at the end of year 1 (CU525). The liability is increased at the end of year 2 to reflect both the fair value of the additional construction (CU525) and the finance charge on the outstanding

financial liability. Because the amount of the predetermined payment related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the payment that reduces the liability. A finance charge at the implicit rate of 6.18% is recognized annually. The liability is subsequently measured at amortized cost, i.e., the amount initially recognized plus the finance charge on that amount calculated using the effective interest method minus repayments.

- IE19. The compensation for the road resurfacing is included in the predetermined series of payments. There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of $\text{CU}110/6 = \text{CU}18$, beginning in year 9.
- IE20. The compensation for maintenance and operating the road (CU12) is included in the predetermined series of payments. There is no cash flow impact related to this service expense; however, the grantor recognizes an expense annually.
- IE21. The costs of services are accounted for in accordance with IPSAS 1.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

- IE22. The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 1.1 to 1.3. In addition, Table 1.4 shows the changes in the financial liability.

Table 1.1 Cash Flows (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Predetermined series of payments	–	–	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(1,600)
Net inflow/ (outflow)	–	–	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(200)	(1,600)

Table 1.2 Statement of Financial Performance (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Service expense	–	–	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(12)	(96)
Finance charge	–	(32)	(67)	(59)	(51)	(43)	(34)	(25)	(22)	(11)	(344)
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/ (deficit)	–	(32)	(135)	(128)	(119)	(111)	(103)	(93)	(90)	(80)	(891)

NOTES:

- Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
- Although these Illustrative Examples use a straight-line depreciation method, it is not intended that this method be used in all cases. Paragraph 76 of IPSAS 17 requires that, “The depreciation method shall reflect the pattern in which the asset’s future economic benefits or service potential is expected to be consumed by the entity.” Likewise, for intangible assets, paragraph 96 of IPSAS 31 requires that, “The depreciable amount of an intangible asset with a finite useful life shall be allocated on a systematic basis over its useful life.”

Table 1.3 Statement of Financial Position (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – original surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total Service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	(200)	(400)	(600)	(800)	(1,000)	(1,200)	(1,400)	(1,600)
Financial liability	(525)	(1,082)	(961)	(832)	(695)	(550)	(396)	(343)	(177)	–
Cumulative surplus/deficit	–	32	167	295	414	525	628	721	811	891

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with IPSAS 17 before the new component of the service concession asset related to the resurfacing is recognized.
2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect depreciation on this additional component (Table 1.2).
3. The financial liability is increased in year 8 for the recognition of the new component of the service concession asset.

Table 1.4 Changes in Financial Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,082	961	832	695	550	396	343	177
Liability recognized along with initial service concession asset	525	525	–	–	–	–	–	–	–	–
Finance charge added to liability prior to payments being made	–	32	–	–	–	–	–	–	–	–
Portion of predetermined series of payments that reduces the liability	–	–	(121)	(129)	(137)	(145)	(154)	(163)	(166)	(177)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,082	961	832	695	550	396	343	177	–

Example 2: The Grantor Gives the Operator the Right to Charge Users a Toll for Use of the Road

Additional Arrangement Terms

IE23. The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of CU200 in each of years 3–10. The total consideration (tolls of CU200 in each of years 3–10) reflects the fair values for each of the services indicated in Exhibit 1, and is intended to cover the cost of constructing the road, annual operating costs of CU12 and reimbursement to the operator for the cost of resurfacing the road in year 8 of CU110.

Financial Statement Impact

IE24. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognized as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is taken annually

(CU56, comprised of CU38 for the base layers and CU18 for the surface layers, starting in year 3).

- IE25. As consideration for the service concession asset, the grantor recognizes a liability under the grant of a right to the operator model for granting the operator the right to collect tolls of CU200 in years 3–10. The liability is recognized as the asset is recognized.
- IE26. The liability is reduced over years 3–10, and the grantor recognizes revenue on that basis because access to the service concession asset is expected to be provided evenly over the term of the service concession arrangement from the point at which the asset is capable of providing economic benefits.
- IE27. The compensation for the road resurfacing is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of $\text{CU}110/6 = \text{CU}18$, beginning in year 9.
- IE28. The compensation for maintenance and operating the road (CU12) is included in the tolls the operator expects to earn over the term of the service concession arrangement. There is no financial statement impact related to this service expense. It does not affect cash flow because the grantor has no cash outflow. It is not recognized as an operating expense because the fair value of the asset and liability initially recognized do not include any service costs the operator may incur.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

- IE29. The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 2.1 to 2.3. In addition, Table 2.4 shows the changes in the liability.

Cash Flows

- IE30. Because there are no payments made to the operator, there are no cash flow impacts for this example.

Table 2.2 Statement of Financial Performance (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability)	–	–	145	145	145	145	145	145	145	145	1160
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/(deficit)	–	–	89	88	89	89	88	89	89	88	709

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period.
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 2.3).
4. All revenue is recognized evenly over the term of the arrangement.

Table 2.3 Statement of Financial Position (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – original surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total Service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	–	–	–	–	–	–	–	–
Liability	(525)	(1,050)	(905)	(760)	(615)	(470)	(325)	(290)	(145)	–
Cumulative surplus/deficit	–	–	(89)	(177)	(266)	(355)	(443)	(532)	(621)	(709)

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with IPSAS 17 before the new component of the service concession asset related to the resurfacing is recognized.
2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect depreciation on this additional component (Table 2.2).
3. The liability is increased in year 8 for the recognition of the new component of the service concession asset.

Table 2.4 Changes in Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	525	1,050	905	760	615	470	325	290	145
Liability recognized along with initial service concession asset	525	525	–	–	–	–	–	–	–	–
Revenue (reduction of liability)	–	–	(145)	(145)	(145)	(145)	(145)	(145)	(145)	(145)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	110	–	–
Balance carried forward	525	1,050	905	760	615	470	325	290	145	–

Example 3: The Grantor Makes a Predetermined Series of Payments to the Operator and Also Grants the Operator the Right to Charge Users a Toll for Use of the Road

Additional Arrangement Terms

IE31. The terms of the arrangement allow the operator to collect tolls from drivers using the road. The operator forecasts that vehicle numbers will remain constant over the duration of the arrangement and that it will receive tolls of CU100 in each of years 3–10. The arrangement also requires the grantor to make a predetermined series of payments to the operator of CU100 annually. The fair value of the right to collect tolls and the predetermined series of payments are considered to compensate the operator equally (i.e., 50% from each form of compensation to the operator).

Financial Statement Impact

IE32. The grantor initially recognizes the service concession asset as property, plant, and equipment at its fair value (total CU1,050, comprised of CU940 related to construction of the base layers and CU110 related to construction of the original surface layers). The asset is recognized as it is constructed (CU525 in year 1 and CU525 in year 2). Depreciation is taken annually (CU56, comprised of CU38 for the base layers and CU18 for the surface layers).

IE33. As consideration for the service concession asset, the grantor recognizes both a liability under the grant of a right to the operator model by granting the operator the right to collect tolls of CU100 in years 3–10, and a financial liability to make payments of CU100 in years 3–10. A liability and a financial liability are recognized as the asset is recognized at the end of

year 1 (CU525). The liability and financial liability are increased at the end of year 2 to reflect both the fair value of the additional construction (CU525) and the finance charge on the outstanding financial liability.

- IE34. The grantor's obligation related to the right granted to the operator to charge tolls and the predetermined payments are regarded as two separate items. Therefore in this arrangement it is necessary to divide the grantor's consideration to the operator into two parts—a liability and a financial liability.
- IE35. The liability of CU525 (recognized evenly at the end of years 1 and 2) is reduced over years 3–10, and the grantor recognizes revenue on the same basis because the tolls are expected to be earned evenly over the term of the service concession arrangement from the point at which the asset is capable of providing service benefits.
- IE36. The grantor initially recognizes a financial liability at fair value equal to half of the fair value of the asset (CU525), recognized evenly at the end of years 1 and 2; a liability under the grant of a right to the operator model is recognized in an amount equal to the other half of the fair value of the asset. The financial liability is also increased at the end of year 2 by the finance charge on the outstanding financial liability. Because the amount of the predetermined payments related to the service component of the service concession arrangement is known, the grantor is able to determine the amount of the payments that reduces the liability. A finance charge at the implicit rate of 6.18% is recognized annually. The liability is subsequently measured at amortized cost, i.e., the amount initially recognized plus the finance charge on that amount calculated using the effective interest method minus repayments.
- IE37. The operator is compensated for the road resurfacing (CU110) equally through the tolls the operator expects to earn over the term of the service concession arrangement and the series of predetermined payments (i.e., 50% from each). There is no direct cash flow impact related to the road resurfacing; however, the grantor recognizes the resurfacing as an asset when the work is undertaken and recognizes depreciation expense of $CU110/6 = CU18$, beginning in year 9.
- IE38. The operator is compensated for maintenance and operating the road (CU12) equally through the tolls the operator expects to earn over the term of the service concession arrangement and the predetermined payment (i.e., 50% from each). There is no direct cash flow impact related to this service expense because the grantor has no cash outflow. However, the grantor recognizes an expense annually for the portion of the compensation related to the series of predetermined payments (CU6). There is no financial statement impact for the remaining CU6 of this service expense. It is not recognized as an operating expense because the fair value of the asset and

liability initially recognized do not include any service costs the operator may incur.

- IE39. The grantor's cash flows, statement of financial performance, and statement of financial position over the duration of the arrangement will be as illustrated in Tables 3.1 to 3.3. In addition, Table 3.4 shows the changes in the liability and Table 3.5 shows the changes in the financial liability.

Overview of Cash Flows, Statement of Financial Performance, and Statement of Financial Position

Table 3.1 Cash Flows (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Predetermined series of payments	–	–	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(800)
Net inflow/ (outflow)	–	–	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(100)	(800)

Table 3.2 Statement of Financial Performance (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10	Total
Revenue (reduction of liability)	–	–	73	72	73	72	73	72	73	72	580
Service expense	–	–	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(6)	(48)
Finance charge	–	(16)	(33)	(30)	(26)	(22)	(17)	(12)	(11)	(5)	(172)
Depreciation – base layers	–	–	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(38)	(304)
Depreciation – original surface layer	–	–	(18)	(19)	(18)	(18)	(19)	(18)	–	–	(110)
Depreciation – replacement surface layer	–	–	–	–	–	–	–	–	(18)	(19)	(37)
Total depreciation	–	–	(56)	(57)	(56)	(56)	(57)	(56)	(56)	(57)	(451)
Annual surplus/(deficit)	–	(16)	(22)	(21)	(15)	(12)	(7)	(2)	–	4	(91)

NOTES:

1. Depreciation in years 3–8 reflects the depreciation on the initially-constructed road surface. It is fully depreciated over that period.
2. Depreciation in years 9–10 reflects the depreciation on the new service concession asset component (surface) recognized in year 8.
3. The revenue (reduction of the liability) includes revenue from the additional liability (Table 3.3).
4. All revenue is recognized evenly over the term of the arrangement.

Table 3.3 Statement of Financial Position (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Service concession asset – base layers	525	940	902	864	826	788	750	712	674	636
Service concession asset – surface layer	–	110	92	73	55	37	18	–	–	–
Service concession asset – replacement surface layer	–	–	–	–	–	–	–	110	92	73
Total service concession asset	525	1,050	994	937	881	825	768	822	766	709
Cash	–	–	(100)	(200)	(300)	(400)	(500)	(600)	(700)	(800)
Liability	(262)	(525)	(452)	(380)	(307)	(235)	(162)	(145)	(72)	–
Financial liability	(263)	(541)	(480)	(416)	(348)	(276)	(199)	(172)	(89)	–
Cumulative surplus/deficit	–	16	38	59	74	86	93	95	95	91

NOTES:

1. In this example, the resurfacing occurs as expected in year 8, when the initially-constructed road surface is fully depreciated. If the resurfacing occurred earlier, the initially-constructed road surface would not be fully depreciated, and would need to be derecognized in accordance with IPSAS 17 before the new component of the service concession asset related to the resurfacing is recognized.
2. The new component of the service concession asset related to the resurfacing is recognized in year 8. Years 9–10 reflect depreciation on this additional component (Table 3.2).
3. The liability is increased in year 8 for the recognition of 50% of the new component of the service concession asset.
4. The financial liability is increased in year 8 for the recognition of 50% of the new component of the service concession asset.

Table 3.4 Changes in Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	262	525	452	380	307	235	162	145	72
Liability recognized along with initial service concession asset	262	263	–	–	–	–	–	–	–	–
Revenue (reduction of liability)	–	–	(73)	(72)	(73)	(72)	(73)	(72)	(73)	(72)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	55	–	–
Balance carried forward	262	525	452	380	307	235	162	145	72	–

Table 3.5 Changes in Financial Liability (Currency Units)

Year	1	2	3	4	5	6	7	8	9	10
Balance brought forward	–	263	541	480	416	348	276	199	172	89
Liability recognized along with initial service concession asset	263	262	–	–	–	–	–	–	–	–
Finance charge added to liability prior to payments being made	–	16	–	–	–	–	–	–	–	–
Portion of predetermined series of payments that reduces the liability	–	–	(61)	(64)	(68)	(72)	(77)	(82)	(83)	(89)
Liability recognized along with replacement surface layers	–	–	–	–	–	–	–	55	–	–
Balance carried forward	263	541	480	416	348	276	199	172	89	–

INTRODUCTION TO THE INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD UNDER THE CASH BASIS OF ACCOUNTING

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

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

The adoption of IPSASs by governments will improve both the quality and comparability of financial information reported by public sector entities around the world. The IPSASB recognizes the right of governments and national standard-setters to establish accounting standards and guidelines for financial reporting in their jurisdictions. The IPSASB considers that this Standard is an important step forward in improving the consistency and comparability of financial reporting under the cash basis of accounting and encourages the adoption of this Standard. Financial statements should be described as complying with this IPSAS only if they comply with all the requirements of Part 1 of this IPSAS.

The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSASs prepared for application by entities adopting the accrual basis of accounting. Entities intending to adopt the accrual basis of accounting at some time in the future may find other publications of the IPSASB helpful, particularly Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities*.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD: FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

Structure of the Standard

This Standard comprises two parts:

- Part 1 is mandatory. It sets out the requirements which are applicable to all entities preparing general purpose financial statements under the cash basis of accounting. It defines the cash basis of accounting, establishes requirements for the disclosure of information in the financial statements and supporting notes, and deals with a number of specific reporting issues. The requirements in this part of the Standard must be complied with by entities which claim to be reporting in accordance with the International Public Sector Accounting Standard *Financial Reporting under the Cash Basis of Accounting*.

Sections 1.1 to 1.8 of Part 1 of this Standard were issued in 2003. Section 1.9 of Part 1, “Presentation of Budget Information in Financial Statements” was issued in 2006. Amendments were made to paragraphs 1.3.4(c), 1.3.7, 1.3.9(c) and Appendix 1 of Part 1 in 2006 as a consequence of the issue of Section 1.9. Section 1.10 of Part 1, “Recipients of External Assistance” was issued in 2007. Amendments were made to paragraphs 1.3.18 and Appendix 1 of Part 1 in 2007 as a consequence of the issue of Section 1.10.

- Part 2 is not mandatory. It identifies additional accounting policies and disclosures that an entity is encouraged to adopt to enhance its financial accountability and the transparency of its financial statements. It includes explanations of alternative methods of presenting certain information.

Paragraphs 2.1.1 to 2.1.59 of Section 2.1, Section 2.2 and Appendices 2, 3, 4 and 5 were issued in 2003. Paragraphs 2.1.37 to 2.1.40 were added to Part 2 in 2006 to encourage certain disclosures about budget and actual amounts, and paragraph 2.1.36 and Appendix 2 were revised as a consequence. Paragraphs 2.1.64 to 2.1.93 were added to Part 2 in 2007 to encourage certain disclosures about external assistance, and paragraphs 2.1.25, 2.1.30 and Appendix 2 were revised as a consequence.

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

CONTENTS

	Introduction	
	Structure of the Standard	
	Part 1: Requirements	
	Objective	Paragraphs
1.1	Scope of the Requirements	1.1.1 – 1.1.7
1.2	The Cash Basis	1.2.1 – 1.2.9
	Definitions	1.2.1 – 1.2.9
	Cash Basis of Accounting	1.2.2
	Cash Equivalents	1.2.3 – 1.2.5
	Cash Controlled by the Reporting Entity	1.2.6 – 1.2.9
1.3	Presentation and Disclosure Requirements	1.3.1 – 1.3.38
	Definitions	1.3.1 – 1.3.3
	Financial Statements	1.3.4 – 1.3.11
	Information to be Presented in the Statement of Cash	
	Receipts and Payments	1.3.12 – 1.3.29
	Classification	1.3.17
	Line Items, Headings and Sub-totals	1.3.18
	Reporting on a Net Basis	1.3.19 – 1.3.23
	Payments by Third Parties on Behalf of the Entity	1.3.24 – 1.3.29
	Accounting Policies and Explanatory	
	Notes.....	1.3.30 – 1.3.38
	Structure of the Notes	1.3.30 – 1.3.31
	Selection and Disclosure of Accounting Policies	1.3.32 – 1.3.38
1.4	General Considerations	1.4.1 – 1.4.25
	Reporting Period.....	1.4.1 – 1.4.3
	Timeliness	1.4.4

Authorization Date	1.4.5 – 1.4.6
Information About the Entity	1.4.7 – 1.4.8
Restrictions on Cash Balances and Access to Borrowings.....	1.4.9 – 1.4.12
Consistency of Presentation	1.4.13 – 1.4.15
Comparative Information	1.4.16 – 1.4.20
Identification of Financial Statements	1.4.21 – 1.4.25
1.5 Correction of Errors	1.5.1 – 1.5.5
1.6 Consolidated Financial Statements	1.6.1 – 1.6.21
Definitions	1.6.1 – 1.6.4
Economic Entity	1.6.2 – 1.6.4
Scope of Consolidated Statements	1.6.5 – 1.6.15
Consolidation Procedures	1.6.16 – 1.6.19
Consolidation Disclosures	1.6.20
Transitional Provisions	1.6.21
1.7 Foreign Currency	1.7.1 – 1.7.8
Definitions	1.7.1
Treatment of Foreign Currency Cash Receipts, Payments and Balances	1.7.2 – 1.7.8
1.8 Effective Date of Sections 1.1 To 1.7 of Part 1 and Transitional Provisions	1.8.1 – 1.8.3
Effective Date	1.8.1
Transitional Provisions—Consolidated Financial Statements	1.8.2 – 1.8.3
1.9 Presentation of Budget Information in Financial Statements	1.9.1 – 1.9.48
Definitions	1.9.1 – 1.9.7
Approved Budgets	1.9.2 – 1.9.4
Original and Final Budget	1.9.5 – 1.9.6
Actual Amounts	1.9.7
Presentation of a Comparison of Budget and Actual Amounts	1.9.8 – 1.9.32

Scope	1.9.9 – 1.9.10
Comparison of Budget and Actual Amounts	1.9.11 – 1.9.16
Presentation	1.9.17 – 1.9.19
Level of Aggregation	1.9.20 – 1.9.22
Changes from Original to Final Budget	1.9.23 – 1.9.24
Comparable Basis	1.9.25 – 1.9.30
Multiyear Budgets	1.9.31 – 1.9.32
Note Disclosures of Budgetary Basis, Period and Scope	1.9.33 – 1.9.40
Reconciliation of Actual Amounts on a Comparable Basis and Actual Amounts in the Financial Statements	1.9.41 – 1.9.46
Effective Date of Section 1.9 of Part 1	1.9.47 – 1.9.48
1.10 Recipients of External Assistance	1.10.1–1.10.34
Definitions	1.10.1–1.10.7
External Assistance	1.10.3–1.10.4
Official Resources	1.10.5
External Assistance Agreements	1.10.6–1.10.7
External Assistance Received	1.10.8–1.10.17
Undrawn External Assistance	1.10.18–1.10.20
Receipt of Goods or Services	1.10.21–1.10.22
Disclosure of Debt Rescheduled or Cancelled	1.10.23–1.10.24
Disclosure of Non-Compliance with Significant Terms and Conditions	1.10.25–1.10.27
Effective Date of Section 1.10 and Transitional Provisions	1.10.28–1.10.34
Appendix 1: Illustration of the Requirements of Part 1 of the Standard	
Part 2: Encouraged Additional Disclosures	
2.1 Encouraged Additional Disclosures	2.1.1 – 2.1.63
Definitions	2.1.1 – 2.1.2
Future Economic Benefits or Service Potential	2.1.2
Going Concern	2.1.3 – 2.1.5

Extraordinary Items	2.1.6 – 2.1.14
Distinct from Ordinary Activities	2.1.8
Not Expected to Recur in the Foreseeable Future	2.1.9
Outside the Control or Influence of the Entity	2.1.10
Identifying Extraordinary Items	2.1.11 – 2.1.14
Administered Transactions	2.1.15 – 2.1.22
Revenue Collection	2.1.18 – 2.1.20
“Pass-through” Cash flows	2.1.21
Transfer Payments	2.1.22
Disclosure of Major Classes of Cash Flows	2.1.23 – 2.1.30
Related Party Disclosures	2.1.31 – 2.1.32
Disclosures of Assets, Liabilities and Comparison with Budgets	2.1.33 – 2.1.40
Comparison with Budgets	2.1.36 – 2.1.40
Consolidated Financial Statements	2.1.41 – 2.1.48
Acquisitions and Disposals of Controlled Entities and Other Operating Units	2.1.44 – 2.1.48
Joint Ventures	2.1.49 – 2.1.50
Financial Reporting in Hyperinflationary Economies	2.1.51 – 2.1.63
The Restatement of Financial Statements	2.1.53 – 2.1.58
Comparative Information	2.1.59
Consolidated Financial Statements	2.1.60 – 2.1.61
Selection and Use of the General Price Index	2.1.62 – 2.1.63
Assistance Received from	
Non-Governmental Organizations (NGOs)	2.1.64–2.1.65
Recipients of External Assistance	2.1.66–2.1.93
2.2 Governments and Other Public Sector Entities Intending to Migrate to the Accrual Basis of Accounting	2.2.1 – 2.2.5
Presentation of the Statement of Cash Receipts and Payments	2.2.1 – 2.2.2

Scope of Consolidated Statements – Exclusions from the Economic Entity	2.2.3 – 2.2.5
Appendix 2: Illustration of Certain Disclosures Encouraged in Part 2 of the Standard	
Appendix 3: Presentation of the Statement of Cash Receipts and Payments in the Format Required by IPSAS 2 Statement of Cash Flows	
Appendix 4: Qualitative Characteristics of Financial Reporting	
Appendix 5: Establishing Control of Another Entity for Financial Reporting Purposes	

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

PART 1: REQUIREMENTS

Part 1 of this Standard sets out the requirements for reporting under the cash basis of accounting.

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

Objective

The purpose of this Standard is to prescribe the manner in which general purpose financial statements should be presented under the cash basis of accounting.

Information about the cash receipts, cash payments and cash balances of an entity is necessary for accountability purposes and provides input useful for assessments of the ability of the entity to generate adequate cash in the future and the likely sources and uses of cash. In making and evaluating decisions about the allocation of cash resources and the sustainability of the entity’s activities, users require an understanding of the timing and certainty of cash receipts and cash payments.

Compliance with the requirements and encouragements of this Standard will enhance comprehensive and transparent financial reporting of the cash receipts, cash payments and cash balances of the entity. It will also enhance comparability with the entity’s own financial statements of previous periods and with the financial statements of other entities which adopt the cash basis of accounting.

1.1 Scope of the Requirements

- 1.1.1 ***An entity which prepares and presents financial statements under the cash basis of accounting, as defined in this Standard, should apply the requirements of Part 1 of this Standard in the presentation of its general purpose annual financial statements.***
- 1.1.2 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. Users of general purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media and employees. General purpose financial statements include those financial statements that are presented separately or within another public document such as an annual report.
- 1.1.3 This Standard applies equally to the general purpose financial statements of an individual entity and to the consolidated general purpose financial statements of an economic entity such as a whole-of-government. It requires the preparation of a statement of cash receipts and payments which recognizes the cash controlled by the reporting entity, and the disclosure of accounting policies and explanatory notes. It also requires that amounts settled on behalf of the reporting entity by third parties be disclosed on the face of the statement of cash receipts and payments.
- 1.1.4 ***An entity whose financial statements comply with the requirements of Part 1 of this Standard should disclose that fact. Financial statements should not be described as complying with this Standard unless they comply with all the requirements in Part 1 of the Standard.***
- 1.1.5 ***This Standard applies to all public sector entities other than Government Business Enterprises.***
- 1.1.6 The *Preface to International Financial Reporting Standards* issued by the International Accounting Standards Board (IASB) explains that International Financial Reporting Standards (IFRSs) are designed to apply to the general purpose financial statements of all profit-oriented entities. Government Business Enterprises (GBEs) are defined in paragraph 1.2.1 below. They are profit-oriented entities. Accordingly, they are required to comply with IFRSs and International Accounting Standards (IASs).
- 1.1.7 The International Accounting Standards Board (IASB) was established in 2001 to replace the International Accounting Standards Committee (IASC). The IASs issued by the IASC remain in force until they are amended or withdrawn by the IASB.

1.2 The Cash Basis

Definitions

1.2.1 *The following terms are used in this Standard with the meaning specified:*

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

Cash basis *means a basis of accounting that recognizes transactions and other events only when cash is received or paid.*

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

Cash flows *are inflows and outflows of cash.*

Cash payments *are cash outflows.*

Cash receipts *are cash inflows.*

Control of cash *arises when the entity can use or otherwise benefit from the cash in pursuit of its objectives and can exclude or regulate the access of others to that benefit.*

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

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

Cash Basis of Accounting

1.2.2 The cash basis of accounting recognizes transactions and events only when cash (including cash equivalents) is received or paid by the entity. Financial statements prepared under the cash basis provide readers with information about the sources of cash raised during the period, the purposes for which cash was used and the cash balances at the reporting date. The measurement focus in the financial statements is balances of cash and changes therein. Notes to the financial statements may provide additional information about liabilities, such as payables and borrowings, and some non-cash assets, such as receivables, investments and property, plant and equipment.

Cash Equivalents

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

Cash Controlled by the Reporting Entity

- 1.2.6 Cash is controlled by an entity when the entity can use the cash for the achievement of its own objectives or otherwise benefit from the cash and exclude or regulate the access of others to that benefit. Cash collected by, or appropriated or granted to, an entity which the entity can use to fund its operating objectives, acquire capital assets or repay its debt is controlled by the entity.
- 1.2.7 Amounts deposited in the bank account of an entity are controlled by that entity. In some cases, cash which a government entity:
- (a) Collects on behalf of its government (or another entity) is deposited in its own bank account before transfer to consolidated revenue or another general government account; and
 - (b) Is to transfer to third parties on behalf of its government is initially deposited in its own bank account prior to transfer to the authorized recipient.

In these cases, the entity will control the cash for only the period during which the cash resides in its bank account prior to transfer to consolidated revenue or another government controlled bank account, or to third parties. Paragraph 1.4.9 requires the disclosure of cash balances held by an entity at reporting date that are not available for use by the entity or are subject to external restrictions. Additional guidance on the treatment of cash flows that an entity administers on

behalf of other entities is included in paragraphs 2.1.15 to 2.1.22 of Part 2 of this Standard.

- 1.2.8 In some jurisdictions, a government will manage the expenditure of its individual departments and other entities through a centralized treasury function, often referred to as a “single account” basis. Under these arrangements, individual departments and entities do not control their own bank accounts. Rather, government monies are managed by a central entity through a “single” government account or series of accounts. The central entity will make payments on behalf of individual departments and entities after appropriate authorization and documentation. Consequently, individual departments and entities do not control the cash that they have been appropriated or otherwise authorized to expend. In these cases, the expenditures made by individual departments and entities will be reported in a separate column headed “treasury account” (or a similarly described column) in the statement of cash receipts and payments in accordance with the requirements of paragraph 1.3.24(a).
- 1.2.9 In some cases, the centralized treasury function will be undertaken by an entity which controls the bank account(s) from which payments on behalf of the individual operating departments and other entities are made. In these cases, transfers to and payments from those bank accounts reflect cash receipts and payments which the central entity administers on behalf of the individual operating departments and other entities. Paragraph 1.3.13 specifies that cash receipts and payments which arise from transactions the entity administers on behalf of other entities and which are recognized in the primary financial statements may be reported on a net basis. Paragraph 1.4.9 requires the disclosure of cash balances held by an entity at reporting date that are not available for use by the entity or are subject to external restrictions.

1.3 Presentation and Disclosure Requirements

Definitions

- 1.3.1 *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.*

Materiality: *information is material if its omission or misstatement could influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the item or error judged in the particular circumstances of omission or misstatement.*

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

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

- 1.3.2 Financial statements result from processing large quantities of transactions that are structured by being aggregated into groups according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data that form line items either 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 that it should be presented separately in the notes.
- 1.3.3 The principle of materiality provides that the specific disclosure requirements of International Public Sector Accounting Standards need not be met if the resulting information is not material.

Financial Statements

- 1.3.4 *An entity should prepare and present general purpose financial statements which include the following components:*
- (a) *A statement of cash receipts and payments which:*
 - (i) *Recognizes all cash receipts, cash payments and cash balances controlled by the entity; and*
 - (ii) *Separately identifies payments made by third parties on behalf of the entity in accordance with paragraph 1.3.24 of this Standard;*
 - (b) *Accounting policies and explanatory notes; and*
 - (c) *When the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the statement of cash receipts and payments in accordance with paragraph 1.9.8 of this Standard.*
- 1.3.5 *When an entity elects to disclose information prepared on a different basis from the cash basis of accounting as defined in this Standard or otherwise required by paragraphs 1.3.4(a) or 1.3.4(c), such information should be disclosed in the notes to the financial statements.*
- 1.3.6 The general purpose financial statements comprises the statement of cash receipts and payments and other statements that disclose additional information about the cash receipts, payments and balances controlled by the entity and accounting policies and notes. In accordance with the requirements of paragraph 1.3.4(a)(i) above, only cash receipts, cash payments and cash balances controlled by the reporting entity will be recognized as such in the statement of cash receipts and payments or other statements that might be prepared. In accordance with the requirements of paragraph 1.3.4(c) above,

the general purpose financial statements may include a comparison of budget and actual amounts as an additional financial statement.

- 1.3.7 Paragraph 1.3.24 of this Standard requires disclosure on the face of the statement of cash receipts and payments of certain payments made by third parties on behalf of the reporting entity. Payments made by third parties will not satisfy the definition of cash, cash payments and cash receipts as defined in paragraph 1.2.1 of this Standard and will not be presented as cash receipts and payments controlled by the reporting entity in the statement of cash receipts and payments or other statements that might be prepared by the reporting entity. Paragraph 1.9.17 of this Standard provides that an entity can present a comparison of budget and actual amounts as additional budget columns in the statement of cash receipts and payments only where the financial statements and the budget are prepared on a comparable basis. When the budget and financial statements are not prepared on a comparable basis, a separate statement of comparison of budget and actual amounts is presented.
- 1.3.8 Notes to the financial statements include narrative descriptions or more detailed schedules or analyses of amounts shown on the face of the financial statements, as well as additional information. They include information required and encouraged to be disclosed by this Standard, and can include other disclosures considered necessary to achieve a fair presentation and enhance accountability.
- 1.3.9 This Standard does not preclude an entity from including in its general purpose financial statements, statements in addition to the statement of cash receipts and payments as specified in paragraph 1.3.4 above. Consequently, general purpose financial statements may also include additional statements which, for example:
- (a) Report cash receipts, cash payments and cash balances for major fund categories such as the consolidated revenue fund;
 - (b) Provide additional information about the sources and deployment of borrowings and the nature and type of cash payments; or
 - (c) Provide a comparison of actual and budget amounts.

In accordance with the requirements of paragraph 1.3.5 above, any additional statements will only report cash receipts, payments and balances which are controlled by the entity.

- 1.3.10 Entities that report using the cash basis of accounting frequently collect information on items that are not recognized under cash accounting. Examples of the type of information that may be collected include details of:
- (a) Receivables, payables, borrowings and other liabilities, non-cash assets and accruing revenues and expenses;
 - (b) Commitments and contingent liabilities; and

- (c) Performance indicators and the achievement of service delivery objectives.
- 1.3.11 Entities preparing general purpose financial statements in accordance with this Standard may disclose such information in the notes to the financial statements where that information is likely to be useful to users. Where such disclosures are made they should be clearly described and readily understandable. If not disclosed in the financial statements themselves, comparisons with budget may also be included in the notes. Part 2 of this Standard encourages inclusion of information about non-cash assets and liabilities and a comparison with budget in general purpose financial statements.

Information to be Presented in the Statement of Cash Receipts and Payments

- 1.3.12 *The statement of cash receipts and payments should present the following amounts for the reporting period:*
- (a) *Total cash receipts of the entity showing separately a sub-classification of total cash receipts using a classification basis appropriate to the entity's operations;*
 - (b) *Total cash payments of the entity showing separately a sub-classification of total cash payments using a classification basis appropriate to the entity's operations; and*
 - (c) *Beginning and closing cash balances of the entity.*
- 1.3.13 *Total cash receipts and total cash payments, and cash receipts and cash payments for each sub-classification of cash receipt and payment, should be reported on a gross basis, except that cash receipts and payments may be reported on a net basis when:*
- (a) *They arise from transactions which the entity administers on behalf of other parties and which are recognized in the statement of cash receipts and payments; or*
 - (b) *They are for items in which the turnover is quick, the amounts are large, and the maturities are short.*
- 1.3.14 *Line items, headings and sub-totals should be presented in the statement of cash receipts and payments when such presentation is necessary to present fairly the entity's cash receipts, cash payments and cash balances.*
- 1.3.15 This Standard requires all entities to present a statement of cash receipts and payments which discloses beginning and closing cash balances of the entity, total cash receipts and total cash payments over the reporting period, and major sub-classifications thereof. This will ensure that the financial statements provide comprehensive information about the cash balances of

the entity and changes therein over the period in a format that is accessible and understandable to users.

- 1.3.16 Disclosure of information about such matters as the cash balances of the entity, whether cash is generated from taxes, fines, fees, and/or borrowings and whether it was expended to meet operating costs, for the acquisition of capital assets or for the retirement of debt will enhance transparency and accountability of financial reporting. These disclosures will also facilitate more informed analysis and assessments of the entity's current cash resources and the likely sources and sustainability of future cash inflows.

Classification

- 1.3.17 The sub-classifications (or classes) of total cash receipts and payments which will be disclosed in accordance with paragraphs 1.3.12 and 1.3.14 are a matter of professional judgment. That judgment will be applied in the context of the objective and qualitative characteristics of financial reporting under the cash basis of accounting. Appendix 4 of this Standard summarizes the qualitative characteristics of financial reporting. Total cash receipts may be classified to, for example, separately identify cash receipts from: taxation or appropriation; grants and donations; borrowings; proceeds from the disposal of property, plant and equipment; and other ongoing service delivery and trading activities. Total cash payments may be classified to, for example, separately identify cash payments in respect of: ongoing service delivery activities including transfers to constituents or other governments or entities; debt reduction programs; acquisitions of property, plant and equipment; and any trading activities. Alternative presentations are also possible, for example total cash receipts may be classified by reference to their source and cash payments may be sub-classified by reference to either the nature of the payments or their function or program within the entity, as appropriate.

Line Items, Headings and Sub-Totals

- 1.3.18 Factors to be taken into consideration in determining which line items, headings and sub-totals should be presented within each sub-classification in accordance with the requirements of paragraph 1.3.14 above include: the requirements of other sections of this Standard (for example, paragraph 1.10.8 requires that total external assistance received in cash during the period be disclosed separately on the face of the Statement of Cash Receipts and Payments); assessments of the likely materiality of the disclosures to users; and the extent to which necessary explanations and disclosures are made in the notes to the financial statements. Paragraphs 2.1.23 to 2.1.30 of Part 2 of this Standard set out disclosures of additional major classes of cash flows that an entity is encouraged to make in the notes to the financial statements or in the financial statements themselves. It is likely that in many, but not necessarily all, cases these disclosures will satisfy the requirements of paragraph 1.3.12 above.

Reporting on a Net Basis

- 1.3.19 This Standard requires the reporting of cash receipts, payments and balances on a gross basis except in the circumstances identified by paragraph 1.3.13 above. Paragraphs 1.3.20 to 1.3.21 below further elaborate on those circumstances in which reporting on a net basis may be justified.
- 1.3.20 Governments and government departments and other government entities may administer transactions and otherwise act as agents on behalf of others. These administered and agency transactions may encompass the collection of revenues on behalf of another entity, the transfer of funds to eligible beneficiaries or the safekeeping of monies on behalf of constituents. Examples of such activities may include:
- (a) The collection of taxes by one level of government for another level of government, not including taxes collected by a government for its own use as part of a tax sharing arrangement;
 - (b) The acceptance and repayment of demand deposits of a financial institution;
 - (c) Funds held for customers by an investment or trust entity;
 - (d) Rents collected on behalf of, and paid over to, the owners of properties;
 - (e) Transfers by a government department to third parties consistent with legislation or other government authority; and
 - (f) Funds administered by a central entity under the “single account” basis for management of government expenditure (as referred to in paragraph 1.2.8).
- 1.3.21 In many cases, the cash an entity receives in respect of transactions it administers as an agent for others will be deposited in trust accounts for, or directly in the bank account of, the ultimate recipients of the cash. In these cases, the entity will not control the cash it receives in respect of the transactions it administers and these cash flows will not form part of the cash receipts, cash payments or cash balances of the entity. However, in other cases the cash received will be deposited in bank accounts controlled by the entity acting as an agent and the receipt and transfer of that cash will be reported in the statement of cash receipts and payments of the entity.
- 1.3.22 In some cases, the amounts of the cash flows arising from administered transactions which “pass-through” the bank account of the reporting entity may be large relative to the entity’s own transactions, and control may occur for only a short time before the amounts are transferred to the ultimate recipients. This may also be true for other cash flows including for example, advances made for, and the repayment of:
- (a) The purchase and sale of investments; and

- (b) Other short-term borrowings, for example, those which have a maturity period of three months or less.

1.3.23 The recognition of these transactions on a gross basis may undermine the ability of the financial statements of some governments and government entities to communicate information about cash receipts and cash payments resulting from the entity's own activities. Accordingly, this Standard permits cash receipts and cash payments to be offset and reported on a net basis in the statement of cash receipts and payments in the circumstances identified in paragraph 1.3.13 above.

Payments by Third Parties on Behalf of the Entity

1.3.24 *Where, during a reporting period, a third party directly settles the obligations of an entity or purchases goods and services for the benefit of the entity, the entity should disclose in separate columns on the face of the statement of cash receipts and payments:*

- (a) *Total payments made by third parties which are part of the economic entity to which the reporting entity belongs, showing separately a sub-classification of the sources and uses of total payments using a classification basis appropriate to the entity's operations; and*
- (b) *Total payments made by third parties which are not part of the economic entity to which the reporting entity belongs, showing separately a sub-classification of the sources and uses of total payments using a classification basis appropriate to the entity's operation.*

Such disclosure should only be made when during the reporting period the entity has been formally advised by the third party or the recipient that such payment has been made or has otherwise verified the payment.

1.3.25 Where a government manages the expenditure of its individual departments and other entities through a centralized treasury function or a "single account" arrangement, payments are made on behalf of those departments and entities by a central entity after appropriate authorization and documentation from the department. In these cases, the department or other entity does not control cash inflows, cash outflows and cash balances. However, the department or other entity benefits from the payments being made on its behalf, and knowledge of the amount of these payments is relevant to users in identifying the cash resources the government has applied to the entity's activities during the period. Consistent with paragraph 1.3.24(a) above, the department or other entity reports in a separate column on the face of the statement of cash receipts and payments, the amount of payments made by the central entity on its behalf, and the sources and uses of the amount expended sub-classified on a basis appropriate for the department or other entity. These disclosures will enable users to identify the total amount of payments made, the purposes for which they were made and whether, for example, the payments were made from amounts allocated or

appropriated from general revenue or from special purpose funds or other sources.

- 1.3.26 In some jurisdictions, government departments or other entities may be established with their own bank accounts and will control certain cash inflows, cash outflows and cash balances. In these jurisdictions, government directions or instructions may also require one department or other government entity to settle certain obligations of another department or entity, or to purchase certain goods or services on behalf of another department or entity. Consistent with paragraph 1.3.24(a) above the reporting entity reports in a separate column on the face of the statement of cash receipts and payments the amount, sources and uses of such expenditures made on its behalf during the reporting period. This will assist users in identifying the total cash resources of the economic entity which have been applied to the entity's activities during the reporting period, and the sources and uses of those cash resources.
- 1.3.27 In some cases, third parties which are not part of the economic entity to which the reporting entity belongs purchase goods or services on behalf of the entity or settle obligations of the entity. For example, a national government may fund the operation of a health or education program of an independent provincial or municipal government by directly paying service providers and acquiring and transferring to the other government the necessary supplies during the period. Similarly, a national government or independent aid agency may pay a construction company directly for building a road for a particular government rather than providing the funds directly to the government itself. These payments may be made by way of a grant or other aid, or as a loan which is to be repaid. In these cases, the provincial or municipal government does not receive cash (including cash equivalents) directly from, or gain control of a bank account or similar facility established for its benefit by, the other entity. Therefore, the amount settled or paid on its behalf does not constitute "cash" as defined in this Standard. However, the government benefits from the cash payments being made on its behalf.
- 1.3.28 Paragraph 1.3.24(b) above requires that an entity report in a separate column on the face of its statement of cash receipts and payments, the amount, sources and uses of expenditures made by third parties which are not part of the economic entity to which it belongs. This will enable users to identify the total cash resources being applied to the entity's activities during the reporting period, and the extent to which those resources are provided from parties which are, and which are not, part of the government to which the reporting entity belongs. In some cases, as at reporting date an entity may not be aware that payments have been made on their behalf by third parties during the reporting period. This may occur where the entity has not been formally advised of the third party payment or cannot otherwise verify that an expected payment has occurred. Paragraph 1.3.24 above requires that third party payments only be disclosed on the face of the statement of cash receipts and payments when during the reporting period the

entity has been formally advised that such payments have been made or otherwise verifies their occurrence.

- 1.3.29 The sub-classifications (or classes) of sources and uses of third party payments which will be disclosed in accordance with paragraphs 1.3.24(a) and 1.3.24(b) are a matter of professional judgment. The factors that will be considered in exercising that judgment are outlined in paragraph 1.3.17.

Accounting Policies and Explanatory Notes

Structure of the Notes

- 1.3.30 *The notes to the financial statements of an entity should:*
- (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 events; and*
 - (b) *Provide additional information which is not presented on the face of the financial statements but is necessary for a fair presentation of the entity's cash receipts, cash payments and cash balances.*
- 1.3.31 *Notes to the financial statements should be presented in a systematic manner. Each item on the face of the statement of cash receipts and payments and other financial statements should be cross referenced to any related information in the notes.*

Selection and Disclosure of Accounting Policies

- 1.3.32 *General purpose financial statements should present information that is:*
- (a) *Understandable;*
 - (b) *Relevant to the decision-making and accountability needs of users; and*
 - (c) *Reliable in that it:*
 - (i) *Represents faithfully the cash receipts, cash payments and cash balances of the entity and the other information disclosed;*
 - (ii) *Is neutral, that is, free from bias; and*
 - (iii) *Is complete in all material respects.*
- 1.3.33 The quality of information provided in general purpose financial statements determines the usefulness of that statement to users. Paragraph 1.3.32 requires the development of accounting policies to ensure that the financial statements provide information that meets a number of qualitative characteristics. Appendix 4 of this Standard summarizes the qualitative characteristics of financial reporting. The appendix also notes that the timeliness of information

may impact upon both the relevance and reliability of the financial information. The maintenance of complete and accurate accounting records during the reporting period is essential for timely production of the general purpose financial statement.

- 1.3.34 ***The accounting policies section of the notes to the financial statements should describe each specific accounting policy that is necessary for a proper understanding of the financial statements, including the extent to which the entity has applied any transitional provisions in this Standard.***
- 1.3.35 ***Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used, or by notes or explanatory material.***
- 1.3.36 In deciding whether a specific accounting policy should be disclosed, management considers whether disclosure would assist users in understanding the way in which transactions and events are reflected in the reported cash receipts, payments and balances. An accounting policy may be significant even if amounts shown for current and prior periods are not material. Paragraph 1.3.4 of this Standard specifies that general purpose financial statements include accounting policies and explanatory notes. Consequently, the requirements of paragraph 1.3.34 above also apply to notes to the financial statements.
- 1.3.37 ***Where an entity elects to include in its financial statements any disclosures encouraged in Part 2 of this Standard, those disclosures should comply with the requirements of paragraph 1.3.32 above.***
- 1.3.38 Part 2 of this Standard encourages the disclosure of additional information in notes to the financial statements. Where such disclosures are made, they will need to be understandable and to satisfy the other qualitative characteristics of financial information.

1.4 General Considerations

Reporting Period

- 1.4.1 ***The general purpose financial statements should be presented at least annually. When, in exceptional circumstances, an entity's reporting date changes and the annual financial statements are presented for a period longer or shorter than one year, an entity should disclose in addition to the period covered by the financial statements:***
- (a) ***The reason(s) for a period other than one year being used; and***
 - (b) ***the fact that comparative amounts may not be comparable.***
- 1.4.2 The reporting date is the date of the last day of the reporting period to which the financial statements relate. In exceptional circumstances an entity may be required to, or decide to, change its reporting date to, for example, align the reporting cycle more closely with the budgeting cycle. When this is the case, it is important that the reason for the change in reporting date is

disclosed and that users are aware that the amounts shown for the current period and the comparative amounts are not comparable.

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

Timeliness

- 1.4.4 The usefulness of the financial statements are impaired if they are not made available to users within a reasonable period after the reporting date. An entity should be in a position to issue its financial statements within six months of the reporting date, although a timeframe of no more than three months is strongly encouraged. Ongoing factors such as the complexity of an entity's operations are not sufficient reason for failing to report on a timely basis. More specific deadlines are dealt with by legislation and regulations in many jurisdictions.

Authorization Date

- 1.4.5 *An entity should disclose the date when the financial statements were authorized for issue and who gave that authorization. If another body has the power to amend the financial statements after issuance, the entity should disclose that fact.*
- 1.4.6 The authorization date is the date on which the financial statements have received approval from the individual or body with the authority to finalize those statements for issue. It is important for users to know when the financial statements were authorized for issue, because the financial statements do not reflect events after this date. It is also important for users to know of the rare circumstances in which any persons or organizations have the authority to amend the financial statements after issuance. Examples of individuals or bodies that may have the power to amend the financial statements after issuance are Ministers, the government of which the entity forms part, Parliament or an elected body of representatives. If changes are made, the amended financial statements are a new set of financial statements.

Information about the Entity

- 1.4.7 *An entity should disclose the following if not disclosed elsewhere in information published with the financial statements:*
- (a) *The domicile and legal form of the entity, and the jurisdiction within which it operates;*
 - (b) *A description of the nature of the entity's operations and principal activities;*

- (c) *A reference to the relevant legislation governing the entity's operations, if any; and*
- (d) *The name of the controlling entity and the ultimate controlling entity of the economic entity (where applicable, if any).*

1.4.8 The disclosure of the information required by paragraph 1.4.7 will enable users to identify the nature of the entity's operations and gain an understanding of the legislative and institutional environment within which it operates. This is necessary for accountability purposes and will assist users in understanding and evaluating the financial statements of the entity.

Restrictions on Cash Balances and Access to Borrowings

1.4.9 *An entity should disclose in the notes to the financial statements together with a commentary, the nature and amount of:*

- (a) *Significant cash balances that are not available for use by the entity;*
- (b) *Significant cash balances that are subject to external restrictions; and*
- (c) *Undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities.*

1.4.10 Cash balances held by an entity would not be available for use by the entity when, for example, a controlled entity operates in a country where exchange controls or other legal restrictions apply and the balances are not available for general use by the controlling entity or other controlled entities.

1.4.11 Cash balances controlled by an entity may be subject to restrictions which limit the purpose or timing of their use. This situation often exists when an entity receives a grant or donation which must be used for a specific purpose. It may also exist where, at reporting date, an entity holds in its own bank accounts cash it has collected for other parties in its capacity as an agent but not yet transferred to those parties. Although these balances are controlled by the entity and reported as a cash balance of the entity, separate disclosure of the amount of such items is helpful to readers.

1.4.12 Undrawn borrowing facilities represent a potential source of cash for an entity. Disclosure of the amount of these facilities by significant type allows readers to assess the availability of such cash, and the extent to which the entity has made use of them during the reporting period.

Consistency of Presentation

1.4.13 *The presentation and classification of items in the financial statements should 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 statements presentation demonstrates that*

the change will result in a more appropriate presentation of events or transactions; or

- (b) ***A change in presentation is required by a future amendment to this Standard.***

- 1.4.14 A major restructuring of service delivery arrangements; the creation of a new, or termination of a major existing, government entity; a significant acquisition or disposal; or a review of the overall presentation of the entity's general purpose financial statements might suggest that the statement of cash receipts and payments or other individual financial statements should be presented differently. For example, a government may dispose of a government savings bank that represents one of its most significant controlled entities and the remaining economic entity conducts mainly administrative and policy advice services. In this case, the presentation of the financial statements identifying a financial institution as a principal activity of the government is unlikely to be relevant.
- 1.4.15 Only if the revised structure is likely to continue, or if the benefit of an alternative presentation is clear, should 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 paragraph 1.4.19. Where an entity complies with this International Public Sector Accounting Standard, a change in presentation to comply with national requirements is permitted as long as the revised presentation is consistent with the requirements of this Standard.

Comparative Information

- 1.4.16 ***Unless a provision of this Standard permits or requires otherwise, comparative information should be disclosed in respect of the previous period for all numerical information required by this Standard to be disclosed in the financial statements, except in respect of the financial statements for the reporting period to which this Standard is first applied. Comparative information should be included in narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.***
- 1.4.17 This Standard requires the presentation of a statement of cash receipts and payments and specifies certain disclosures that are required to be made in that statement and notes thereto. This Standard does not preclude the preparation of additional financial statements. Part 2 of this Standard encourages certain additional disclosures. Where financial statements in addition to the statement of cash receipts and payments are prepared or disclosures encouraged by Part 2 of this Standard are made, the disclosure of comparative information is also encouraged.

- 1.4.18 In some cases, narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last reporting date and is yet to be resolved, may be disclosed in the current period. Users benefit from knowing that the uncertainty existed at the last reporting date, and the steps that have been taken during the period to resolve the uncertainty.
- 1.4.19 ***When the presentation or classification of items required to be disclosed in the financial statements is amended, comparative amounts should be reclassified, unless it is impracticable to do so, to ensure comparability with the current period, and the nature, amount of, and reason for any reclassification should be disclosed. When it is impracticable to reclassify comparative amounts, an entity should disclose the reason for not reclassifying and the nature of the changes that would have been made if amounts were reclassified.***
- 1.4.20 Circumstances may exist when it is impracticable to reclassify comparative information to achieve comparability with the current period. For example, data may not have been collected in the previous period(s) in a way which allows reclassification, and it may not be practicable to recreate the information. In such circumstances, the nature of the adjustments to comparative amounts that would have been made is disclosed.

Identification of Financial Statements

- 1.4.21 ***The financial statements should be clearly identified and distinguished from other information in the same published document.***
- 1.4.22 This Standard applies only to the financial statements, and not to other information presented in an annual report or other document. Therefore, it is important that users are able to distinguish information that is prepared using this Standard from other information that may be useful to users but that is not the subject of this Standard.
- 1.4.23 ***Each component of the financial statements should be clearly identified. In addition, the following information should be prominently displayed 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;***
 - (b) ***Whether the financial statements cover the individual entity or the economic entity;***
 - (c) ***The reporting date or the period covered by the financial statements, whichever is appropriate to the related component of the financial statements;***
 - (d) ***The reporting currency; and***

(e) ***The level of precision used in the presentation of figures in the financial statements.***

- 1.4.24 The requirements in paragraph 1.4.23 are normally met by presenting page headings and abbreviated column headings on each page of the financial statements. Judgment is required in determining the best way of presenting such information. For example, when the financial statements are read electronically, separate pages may not be used. In such cases, the items identified in paragraph 1.4.23 are presented frequently enough to ensure a proper understanding of the information given.
- 1.4.25 Financial statements are often made more understandable by presenting information in thousands or millions of units of the reporting currency. This is acceptable as long as the level of precision in presentation is disclosed and relevant information is not lost.

1.5 Correction of Errors

- 1.5.1 ***When an error arises in relation to a cash balance reported in the financial statements, the amount of the error that relates to prior periods should be reported by adjusting the cash at the beginning of the period. Comparative information should be restated, unless it is impracticable to do so.***
- 1.5.2 ***An entity should disclose in the notes to the financial statements the following:***
- (a) ***The nature of the error;***
 - (b) ***The amount of the correction; and***
 - (c) ***The fact that comparative information has been restated or that it is impracticable to do so.***
- 1.5.3 Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, fraud or oversights. When an error is identified in respect of a previous period, the opening balance of cash is adjusted to correct the error and the financial statements, including the comparative information for prior periods, is presented as if the error had been corrected in the period in which it was made. An explanation of the error and its adjustment is included in the notes.
- 1.5.4 The restatement of comparative information does not necessarily give rise to the amendment of financial statements which have been approved by the governing body or registered or filed with regulatory authorities. However, national laws may require the amendment of such financial statements.
- 1.5.5 This Standard requires the presentation of a statement of cash receipts and payments, and does not preclude the presentation of other financial statements.

Where financial statements in addition to the statement of cash receipts and payments are presented, the requirements in paragraphs 1.5.1 and 1.5.2 for correction of errors will also apply to those statements.

1.6 Consolidated Financial Statements

Definitions

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

Consolidated financial statements *are the financial statements of an economic entity presented as that of a single entity.*

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

Controlled entity *is an entity that is under the control of another entity (known as the controlling entity).*

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

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

Economic Entity

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

Scope of Consolidated Financial Statements

- 1.6.5 *A controlling entity, other than a controlling entity identified in paragraphs 1.6.7 and 1.6.8, should issue consolidated financial statements which consolidates all controlled entities, foreign and domestic, other than those referred to in paragraph 1.6.6.*
- 1.6.6 *A controlled entity should be excluded from consolidation when it operates under severe external long-term restrictions which prevent the controlling entity from benefiting from its activities.*
- 1.6.7 *A controlling entity that is a wholly owned controlled entity need not present consolidated financial statements provided users of such financial statements*

are unlikely to exist or their information needs are met by the controlling entity's consolidated financial statements.

- 1.6.8 ***A controlling entity that is virtually wholly owned need not present consolidated financial statements provided the controlling entity obtains the approval of the owners of the minority interest.***
- 1.6.9 Users of the financial statements of a government or other public sector controlling entity are usually concerned with, and need to be informed about, the cash resources controlled by the economic entity as a whole. This need is served by consolidated financial statements which present financial information about the economic entity as a single entity without regard for the legal boundaries of the separate legal entities.
- 1.6.10 Paragraph 1.3.4 of this Standard requires that a reporting entity prepare a statement of cash receipts and payments. Consistent with the requirements of paragraph 1.6.5 above, the statement of cash receipts and payments prepared by a government or other public sector reporting entity which is a controlling entity, will consolidate the cash receipts, cash payments and cash balances of all the entities it controls. The note disclosures required by Part 1 of this Standard will also be presented on a consolidated basis. Appendix 5 of this Statement illustrates the application of the concept of control in determining the financial reporting entity.
- 1.6.11 This Standard does not preclude the preparation of financial statements additional to the statement of cash receipts and payments. Those additional statements may, for example, disclose additional information about receipts and payments related to certain fund groups or provide additional details about certain types of cash flows. Part 2 of this Standard identifies additional disclosures that an entity is encouraged to make. The additional statements and disclosures will also report consolidated information where appropriate.
- 1.6.12 For financial reporting purposes, the reporting entity (financial reporting entity) may consist of a number of controlled entities including government departments, agencies and Government Business Enterprises (GBEs). Determining the scope of the financial reporting entity can be difficult due to the large number of potential entities. For this reason, financial reporting entities are often determined by legislation. In some cases, the financial reporting entity required by this Standard may differ from the reporting entity specified by legislation and additional disclosures may be necessary to satisfy the legislative reporting requirements.
- 1.6.13 A controlling entity that is itself wholly owned by another entity (such as a government agency which is wholly owned by the government), is not required to present consolidated financial statements when such statements are not required by its controlling entity and the needs of other users may be best served by the consolidated financial statements of its controlling entity. However, in the public sector, many controlling entities that are either

wholly owned or virtually wholly owned represent key sectors or activities of a government. In these cases, the information needs of certain users may not be served by the presentation of a consolidated financial statement at a whole-of-government level alone, and the purpose of this Standard is not to exempt such entities from preparing consolidated financial statements. In many jurisdictions, governments have acknowledged this and have legislated the financial reporting requirements of such entities.

- 1.6.14 In some jurisdictions, a controlling entity which is virtually wholly owned by another entity (such as a government enterprise which has some minor ownership from the private sector) is also exempted from presenting consolidated financial statements if the controlling entity obtains the approval of the owners of the minority interest. Virtually wholly owned is often taken to mean that the controlling entity owns 90% or more of the voting power. For the purpose of this Standard, the minority interest is that part of a controlled entity attributable to interests which are not owned, directly or indirectly through controlled entities, by the controlling entity.
- 1.6.15 In some instances, an economic entity will include a number of intermediate controlling entities. For example, whilst a department of health may be the controlling entity, there may be intermediate controlling entities at the local or regional health authority level. Accountability and reporting requirements in each jurisdiction may specify which entities are required to (or exempted from the requirement to) prepare a consolidated financial statement. Where there is no requirement for an intermediate controlling entity to prepare consolidated financial statements but users of general purpose financial statements of the economic entity are likely to exist, intermediate controlling entities are encouraged to prepare and publish such a statement.

Consolidation Procedures

1.6.16 *The following consolidation procedures apply:*

- (a) *Cash balances and cash transactions between entities within the economic entity should be eliminated in full;*
- (b) *When the financial statements used in a consolidation are drawn up to different reporting dates, adjustments should be made for the effects of significant cash transactions that have occurred between those dates and the date of the controlling entity's financial statements. In any case, the difference between the reporting dates should be no more than three months; and*
- (c) *Consolidated financial statements should be prepared using uniform accounting policies for like cash transactions. 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.

- 1.6.17 The consolidation procedures outlined in paragraph 1.6.16 provide the basis for preparing consolidated financial statements for all the entities within the economic entity as a single economic unit.
- 1.6.18 The consolidated financial statements should only reflect transactions between the economic entity and other entities external to it. Accordingly, transactions between entities within the economic entity are eliminated to avoid double-counting. For example, a government department may sell a physical asset to another government department. Because the net cash effect on the whole-of-government reporting entity is zero, this transaction needs to be eliminated to avoid overstating the cash receipts and cash payments of the whole-of-government reporting entity. A government entity may hold funds with a public sector financial institution. These balances would be eliminated at the whole-of-government level because they represent balances within the economic entity. Similarly, a GBE operating overseas may make a payment to a government department which remains in transit at the reporting date. In this case, failure to eliminate the transaction would result in understating the cash balance of the economic entity and overstating its cash payments.
- 1.6.19 Individual entities within the economic entity may adopt different policies for the classification of cash receipts and cash payments and the presentation of their financial statements. Cash receipts or cash payments arising from like transactions are classified and presented in a uniform manner in the consolidated financial statements where practicable.

Consolidation Disclosures

- 1.6.20 ***The following disclosures should be made in consolidated financial statements:***
- (a) ***A listing of significant controlled entities including the name, the jurisdiction in which the controlled entity operates (when it is different from that of the controlling entity); and***
 - (b) ***The reasons for not consolidating a controlled entity.***

Transitional Provisions

- 1.6.21 Controlling entities that adopt this Standard may have large numbers of controlled entities with significant volumes of transactions between those entities. Accordingly, it may be difficult to identify all the transactions and balances that need to be eliminated for the purpose of preparing the consolidated financial statements of the economic entity. For this reason, paragraph 1.8.2 provides relief, during the transitional period, from the requirement to eliminate all cash balances and transactions between entities within the economic entity. However, paragraph 1.8.3 requires that entities which apply the transitional

provision should disclose the fact that not all balances and transactions between entities within the economic entity have been eliminated.

1.7 Foreign Currency

Definitions

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

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

Exchange difference is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.

Exchange rate is the ratio for exchange of two currencies.

Foreign currency is a currency other than the reporting currency of an entity.

Reporting currency is the currency used in presenting the financial statements.

Treatment of Foreign Currency Cash Receipts, Payments and Balances

1.7.2 *Cash receipts and payments arising from transactions in a foreign currency should be recorded in an entity's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the receipts and payments.*

1.7.3 *Cash balances held in a foreign currency should be reported using the closing rate.*

1.7.4 *The cash receipts and cash payments of a foreign controlled entity should be translated at the exchange rates between the reporting currency and the foreign currency at the dates of the receipts and payments.*

1.7.5 *An entity should disclose the amount of exchange differences included as reconciling items between opening and closing cash balances for the period.*

1.7.6 *When the reporting currency is different from the currency of the country in which the entity is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.*

1.7.7 Governments and government entities may have transactions in foreign currencies such as borrowing an amount of foreign currency or purchasing goods and services where the purchase price is designated as a foreign currency amount. They may also have foreign operations and transfer cash to and receive cash from those foreign operations. In order to include foreign currency

transactions and foreign operations in financial statements the entity must express cash receipts, payments and balances in reporting currency terms.

- 1.7.8 Unrealized gains and losses arising from changes in foreign currency exchange rates are not cash receipts and payments. However, the effect of exchange rate changes on cash held in a foreign currency is reported in the statement of cash receipts and payments in order to reconcile cash at the beginning and the end of the period. This amount is presented separately from cash receipts and payments and includes the differences, if any, had those cash receipts payments and balances been reported at end-of-period exchange rates.

1.8 Effective Date of Sections 1 to 7 of Part 1 and Transitional Provisions

Effective Date

- 1.8.1 *Sections 1 to 7 of Part 1 of this International Public Sector Accounting Standard become effective for annual financial statements covering periods beginning on or after 1 January 2004. Earlier application is encouraged.*

Transitional Provisions—Consolidated Financial Statements

- 1.8.2 *Entities are not required to comply with the requirement in paragraph 1.6.16(a) concerning the elimination of cash balances and transactions between entities within the economic entity for reporting periods beginning on a date within three years following the date of first adoption of this Standard.*
- 1.8.3 *Where entities apply the transitional provision in paragraph 1.8.2, they should disclose the fact that not all balances and transactions between entities within the economic entity have been eliminated.*

1.9 Presentation of Budget Information in Financial Statements

Definitions

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

Accounting basis means the accrual or cash basis of accounting as defined in the accrual basis International Public Sector Accounting Standards and the Cash Basis International Public Sector Accounting Standard.

Annual budget means an approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.

Appropriation is an authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority.

Approved budget means the expenditure authority derived from laws, appropriation bills, government ordinances and other decisions related to the anticipated revenue or receipts for the budgetary period.

Budgetary basis means the accrual, cash or other basis of accounting adopted in the budget that has been approved by the legislative body.

Comparable basis means the actual amounts presented on the same accounting basis, same classification basis, for the same entities and for the same period as the approved budget.

Final budget is the original budget adjusted for all reserves, carry over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative or similar authority changes applicable to the budget period.

multiyear budget is an approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.

Original budget is the initial approved budget for the budget period.

Approved Budgets

- 1.9.2 An approved budget as defined by this Standard reflects the anticipated revenues or receipts expected to arise in the annual or multiyear budget period based on current plans and the anticipated economic conditions during that budget period, and expenses or expenditures approved by a legislative body, being the legislature or other relevant authority. An approved budget is not a forward estimate or a projection based on assumptions about future events and possible management actions which are not necessarily expected to take place. Similarly, an approved budget differs from prospective financial information which may be in the form of a forecast, a projection or a combination of both – for example, a one year forecast plus a five year projection.
- 1.9.3 In some jurisdictions, budgets may be signed into law as part of the approval process. In other jurisdictions, approval may be provided without the budget becoming law. Whatever the approval process, the critical feature of approved budgets is that the authority to withdraw funds from the government treasury or similar body for agreed and identified purposes is provided by a higher legislative body or other appropriate authority. The approved budget establishes the expenditure authority for the specified items. The expenditure authority is generally considered the legal limit within which an entity must operate. In some jurisdictions, the approved budget for which the entity will be held accountable may be the original budget and in others it may be the final budget.
- 1.9.4 If a budget is not approved prior to the beginning of the budget period, the original budget is the budget that was first approved for application in the budget year.

Original and Final Budget

- 1.9.5 The original budget may include residual appropriated amounts automatically carried over from prior years by law. For example, governmental budgetary processes in some jurisdictions include a legal provision that requires the automatic rolling forward of appropriations to cover prior year commitments. Commitments encompass possible future liabilities based on a current contractual agreement. In some jurisdictions, they may be referred to as obligations or encumbrances and include outstanding purchase orders and contracts where goods or services have not yet been received.
- 1.9.6 Supplemental appropriations may be necessary where the original budget did not adequately envisage expenditure requirements arising from, for example, war or natural disasters. In addition, there may be a shortfall in budgeted receipts during the period, and internal transfers between budget heads or line items may be necessary to accommodate changes in funding priorities during the fiscal period. Consequently, the funds allotted to an entity or activity may need to be cut back from the amount originally appropriated for the period in order to maintain fiscal discipline. The final budget includes all such authorized changes or amendments.

Actual Amounts

- 1.9.7 This Standard uses the term actual or actual amounts to describe the amounts that result from execution of the budget. In some jurisdictions, budget out-turn, budget execution or similar terms may be used with the same meaning as actual or actual amounts.

Presentation of a Comparison of Budget and Actual Amounts

- 1.9.8 *Subject to the requirements of paragraph 1.9.17, an entity that makes publicly available its approved budget(s) shall present a comparison of the budget amounts for which it is held publicly accountable and actual amounts either as a separate additional financial statement or as additional budget columns in the statement of cash receipts and payments currently presented in accordance with this Standard. The comparison of budget and actual amounts shall present separately for each level of legislative oversight:*
- (a) *The original and final budget amounts;*
 - (b) *The actual amounts on a comparable basis; and*
 - (c) *By way of note disclosure, an explanation of material differences between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements, and a cross reference to those documents is made in the notes.*

Scope

- 1.9.9 This Standard applies to all entities that are required to, or elect to, make publicly available their approved budget(s). This Standard does not require approved budgets to be made publicly available, nor does it require that the financial statements disclose information about, or include comparisons with, approved budgets which are not made publicly available.
- 1.9.10 In some cases, approved budgets will be compiled to encompass all the activities controlled by a public sector entity. In other cases, separate approved budgets may be required to be made publicly available for certain activities, groups of activities or entities included in the financial statements of a government or other public sector entity. This may occur where, for example, a government's financial statements encompass government agencies or programs that have operational autonomy and prepare their own budgets, or where a budget is prepared only for the general government sector of the whole-of-government. This Standard applies to all entities which present financial statements when approved budgets for the entity, or components thereof, are made publicly available.

Comparison of Budget and Actual Amounts

- 1.9.11 Presentation in the financial statements of the original and final budget amounts and actual amounts on a comparable basis with the budget, which is made publicly available, will complete the accountability cycle by enabling users of the financial statements to identify whether resources were obtained and used in accordance with the approved budget. Differences between the actual amounts and the budget amounts, whether original or final budget (often referred to as the "variance" in accounting), may also be presented in the financial statements for completeness.
- 1.9.12 An explanation of the material differences between actual amounts and the budget amounts will assist users in understanding the reasons for material departures from the approved budget for which the entity is held publicly accountable.
- 1.9.13 An entity may be required, or may elect, to make publicly available its original budget, its final budget or both its original and final budget. In circumstances where both original and final budget are required to be made publicly available, the legislation, regulation or other authority will often provide guidance on whether explanation of material differences between actual and the original budget amounts, or actual and the final budget amounts, is required in accordance with paragraph 1.9.8(c). In the absence of any such guidance, material differences may be determined by reference to, for example, differences between actual and original budget to focus on performance against original budget, or differences between actual and final budget to focus on compliance with the final budget.

- 1.9.14 In many cases, the final budget amount and the actual amount will be the same. This is because budget execution is monitored over the reporting period and the original budget progressively revised to reflect changing conditions, changing circumstances and experiences during the reporting period. Paragraph 1.9.23 of this Standard requires the disclosure of an explanation of the reasons for changes between the original and final budget. That disclosure, together with the disclosures required by paragraph 1.9.8 above, will ensure that entities which make publicly available their approved budget(s) are held publicly accountable for their performance against, and compliance with, the relevant approved budget.
- 1.9.15 Management discussion and analysis, operations review or other public reports which provide commentary on the performance and achievements of the entity during the reporting period, including explanations of any material differences from budget amounts, are often issued in conjunction with the financial statements. In accordance with paragraph 1.9.8(c) of this Standard, explanation of material differences between actual and budget amounts will be included in notes to the financial statements unless included in other public reports or documents issued in conjunction with the financial statements, and the notes to the financial statements identify the reports or documents in which the explanation can be found.
- 1.9.16 Where approved budgets are only made publicly available for some of the entities or activities included in the financial statements, the requirements of paragraph 1.9.8 will apply to only the entities or activities reflected in the approved budget. This means that where, for example, a budget is prepared only for the general government sector of a whole-of-government reporting entity, the disclosures required by paragraph 1.9.8 will be made only in respect of the general government sector of the government.

Presentation

- 1.9.17 ***An entity shall present a comparison of budget and actual amounts as additional budget columns in the statement of cash receipts and payments only where the financial statements and the budget are prepared on a comparable basis.***
- 1.9.18 Comparisons of budget and actual amounts may be presented in a separate financial statement (“statement of comparison of budget and actual amounts” or a similarly titled statement). Alternatively, where the financial statements and the budget are prepared on a comparable basis – that is, on the same basis of accounting for the same entity and reporting period, and adopt the same classification structure – additional columns may be added to the statement of cash receipts and payments presented in accordance with this Standard. These additional columns will identify original and final budget amounts and, if the entity so chooses, differences between the budget and actual amounts.

- 1.9.19 When the budget and financial statements are not prepared on a comparable basis, a separate statement of comparison of budget and actual amounts is presented. In these cases, to ensure that readers do not misinterpret financial information which is prepared on different bases, the financial statements could usefully clarify that the budget and the accounting bases differ and the statement of comparison of budget and actual amounts is prepared on the budget basis.

Level of Aggregation

- 1.9.20 Budget documents may provide great detail about particular activities, programs or entities. These details are often aggregated into broad classes under common budget heads, budget classifications or budget headings for presentation to, and approval by, the legislature or other authoritative body. The disclosure of budget and actual information consistent with those broad classes and budget heads or headings will ensure that comparisons are made at the level of legislative or other authoritative body oversight identified in the budget document(s).
- 1.9.21 In some cases, the detailed financial information included in approved budgets may need to be aggregated for presentation in financial statements in accordance with the requirements of this Standard. Such aggregation may be necessary to avoid information overload and to reflect relevant levels of legislative or other authoritative body oversight. Determining the level of aggregation will involve professional judgment. That judgment will be applied in the context of the objective of this Standard and the qualitative characteristics of financial reporting as identified in paragraph 1.3.32 of this Standard.
- 1.9.22 Additional budget information, including information about service achievements, may be presented in documents other than financial statements. Part 2 of this Standard encourages the inclusion in the financial statements of a cross reference to such documents.

Changes from Original to Final Budget

- 1.9.23 *An entity shall present an explanation of whether changes between the original and final budget are a consequence of reallocations within the budget, or of other factors, either:*
- (a) *By way of note disclosure in the financial statements; or*
 - (b) *In a report issued before, at the same time as, or in conjunction with the financial statements, and shall include a cross reference to the report in the notes to the financial statements.*
- 1.9.24 The final budget includes all changes approved by legislative actions or other designated authority to revise the original budget. Consistent with the requirements of this Standard, notes to the financial statements or a separate report issued before, in conjunction with or at the same time as the financial statements, will include an explanation of changes between the original and

final budget. That explanation will include whether, for example, changes arise as a consequence of reallocations within the original budget parameters or as a consequence of other factors, such as changes in the overall budget parameters, including changes in government policy. Such disclosures are often made in a management discussion and analysis or similar report on operations issued in conjunction with, but not as part of, the financial statements. Such disclosures may also be included in budget out-turn reports issued by governments to report on budget execution. Where such disclosures are made in a separate report rather than in the notes to the financial statements, the notes will include a cross reference to that report.

Comparable Basis

- 1.9.25 *All comparisons of budget and actual amounts shall be presented on a comparable basis to the budget.*
- 1.9.26 The comparison of budget and actual amounts will be presented on the same accounting basis (accrual, cash or other basis), same classification basis and for the same entities and period as for the approved budget. This will ensure that the disclosure of information about compliance with the budget in the financial statements is on the same basis as the budget itself. In some cases, this may mean presenting a budget and actual comparison on a different basis of accounting, for a different group of activities, and with a different presentation or classification format than that adopted for the financial statements.
- 1.9.27 Financial statements consolidate entities and activities controlled by the entity. As noted in paragraph 1.9.10, separate budgets may be approved and made publicly available for individual entities or particular activities that make up the consolidated financial statements. Where this occurs, the separate budgets may be recompiled for presentation in the financial statements in accordance with the requirements of this Standard. Where such recompilation occurs, it will not involve changes or revisions to approved budgets. This is because this Standard requires a comparison of actual amounts with the approved budget amounts.
- 1.9.28 Entities may adopt different bases of accounting for the preparation of their financial statements and for their approved budgets. For example, in some, albeit rare, cases a government or government agency may adopt the cash basis for its financial statements and the accrual basis for its budget. In addition, budgets may focus on, or include information about, commitments to expend funds in the future and changes in those commitments, while the financial statements will report cash receipts and payments and balances thereof. However, the budget entity and financial reporting entity will often be the same. Similarly, the period for which the budget is prepared and the classification basis adopted for the budget will often be reflected in financial statements. This will ensure that the accounting system records and reports financial information in a manner which facilitates the comparison of budget and actual data for management and for accountability purposes – for example, for monitoring

progress of execution of the budget during the budget period and for reporting to the government, the public and other users on a relevant and timely basis.

- 1.9.29 In some jurisdictions, budgets may be prepared on a cash or accrual basis consistent with a statistical reporting system that encompasses entities and activities different from those included in the financial statements. For example, budgets prepared to comply with a statistical reporting system may focus on the general government sector and encompass only entities fulfilling the “primary” or “non-market” functions of government as their major activity, while financial statements report on all activities controlled by a government, including the business activities of the government.
- 1.9.30 In statistical reporting models, the general government sector may comprise national, state/provincial and local government levels. In some jurisdictions, the national government may control state/provincial and local governments, consolidate those governments in its financial statements and develop, and require to be made publicly available, an approved budget that encompasses all three levels of government. In these cases, the requirements of this Standard will apply to the financial statements of those national governmental entities. However, where a national government does not control state or local governments, its financial statement will not consolidate state/provincial or local governments. Rather, separate financial statements are prepared for each level of government. The requirements of this Standard will only apply to the financial statements of governmental entities when approved budgets for the entities and activities they control, or subsections thereof, are made publicly available.

Multiyear Budgets

- 1.9.31 Some governments and other entities approve and make publicly available multiyear budgets, rather than separate annual budgets. Conventionally, multiyear budgets comprise a series of annual budgets or annual budget targets. The approved budget for each component annual period reflects the application of the budgetary policies associated with the multiyear budget for that component period. In some cases, the multiyear budget provides for a roll forward of unused appropriations in any single year.
- 1.9.32 Governments and other entities with multiyear budgets may take different approaches to determining their original and final budget depending on how their budget is passed. For example, a government may pass a biennial budget that contains two approved annual budgets, in which case an original and final approved budget for each annual period will be identifiable. If unused appropriations from the first year of the biennial budget are legally authorized to be spent in the second year, the “original” budget for the second year period will be increased for these “carry over” amounts. In the rare cases in which a government passes a biennial or other multi-period budget that does not specifically separate budget amounts into each annual period, judgment may be

necessary in identifying which amounts are attributable to each annual period for determining the annual budget for the purposes of this Standard. For example, the original and final approved budget for the first year of a biennial period will encompass any approved capital acquisitions for the biennial period that occurred during the first year, together with the amount of the recurring revenue and expenditure items attributable to that year. The unexpended amounts from the first annual period would then be included in the “original” budget for the second annual period and that budget together with any amendments thereto would form the final budget for the second year. Part 2 of this Standard encourages disclosure of the relationship between budget and actual amounts during the budget period.

Note Disclosures of Budgetary Basis, Period and Scope

- 1.9.33 *An entity shall explain in notes to the financial statements the budgetary basis and classification basis adopted in the approved budget.*
- 1.9.34 There may be differences between the accounting basis (cash, accrual, or some modification thereof) used in preparation and presentation of the budget and the accounting basis used in the financial statements. These differences may occur when the accounting system and the budget system compile information from different perspectives – the budget may focus on cash flows plus certain accruals and commitments, while the financial statements report cash receipts and cash payments.
- 1.9.35 Formats and classification schemes adopted for presentation of the approved budget may also differ from the formats adopted for the financial statements. An approved budget may classify items on the same basis as is adopted in the financial statements, for example, expenditures by economic nature (compensation of employees, supplies and consumables, grants and transfers, etc.) or function (health, education, etc.). Alternatively, the budget may classify items by specific programs (for example, poverty reduction or control of contagious diseases) or program components linked to performance outcome objectives (for example, students graduating from tertiary education or surgical operations performed by hospital emergency services), which differ from classifications adopted in the financial statements. Further, a recurrent budget for ongoing operations (for example, education or health) may be approved separately from a capital budget for capital outlays (for example, infrastructure or buildings).
- 1.9.36 Disclosure of the budgetary basis and classification basis adopted for the preparation and presentation of approved budgets will assist users to better understand the relationship between the budget and accounting information disclosed in the financial statements.
- 1.9.37 *An entity shall disclose in notes to the financial statements the period of the approved budget.*

- 1.9.38 Financial statements are presented at least annually. Entities may approve budgets for an annual period or for multiyear periods. Disclosure of the period covered by the approved budget where that period differs from the reporting period adopted for the financial statements will assist the user of those financial statements to better understand the relationship of the budget data and budget comparison to the financial statements. Disclosure of the period covered by the approved budget where that period is the same as the period covered by the financial statements will also serve a useful confirmation role, particularly in jurisdictions where interim budgets and financial statements and reports are also prepared.
- 1.9.39 *An entity shall identify in notes to the financial statements the entities included in the approved budget.*
- 1.9.40 Paragraph 1.6.5 of this Standard requires controlling entities to prepare and present consolidated financial statements which encompass budget-dependent entities and GBEs controlled by the government. However, as noted in paragraph 1.9.29, approved budgets prepared in accordance with statistical reporting models may not encompass operations of the government that are undertaken on a commercial or market basis. Consistent with the requirements of paragraph 1.9.25, budget and actual amounts will be presented on a comparable basis. Disclosure of the entities encompassed by the budget will enable users to identify the extent to which the entity's activities are subject to an approved budget and how the budget entity differs from the entity reflected in the financial statements.

Reconciliation of Actual Amounts on a Comparable Basis and Actual Amounts in the Financial Statements

- 1.9.41 *The actual amounts presented on a comparable basis to the budget in accordance with paragraph 1.9.25 shall, where the financial statements and the budget are not prepared on a comparable basis, be reconciled to total cash receipts and total cash payments, identifying separately any basis, timing and entity differences. The reconciliation shall be disclosed on the face of the statement of comparison of budget and actual amounts or in the notes to the financial statements.*
- 1.9.42 Differences between the actual amounts identified consistent with the comparable basis and the actual amounts recognized in the financial statements can usefully be classified into the following:
- (a) Budgetary basis differences, which occur when the approved budget is prepared on a basis other than the accounting basis. For example, where the budget is prepared on the accrual basis or modified cash basis and the financial statements are prepared on the cash basis;
 - (b) Timing differences, which occur when the budget period differs from the reporting period reflected in the financial statements; and

- (c) Entity differences, which occur when the budget omits programs or entities that are part of the entity for which the financial statements are prepared.

There may also be differences in formats and classification schemes adopted for presentation of financial statements and the budget.

- 1.9.43 The reconciliation required by paragraph 1.9.41 of this Standard will enable the entity to better discharge its accountability obligations by identifying major sources of difference between the actual amounts on a budget basis and the total cash receipts and total cash payments recognized in the statement of cash receipts and payments. This Standard does not preclude reconciliation of each major total and subtotal, or each class of items, presented in a comparison of budget and actual amounts with the equivalent amounts in the financial statements.
- 1.9.44 For entities adopting the cash basis of accounting for preparation of both the budget documents and the financial statements, a reconciliation will not be required where the budget is prepared for the same period, encompasses the same entities and adopts the same presentation format as the financial statements. For other entities adopting the same basis of accounting for the budget and the financial statements, there may be a difference in presentation format, reporting entity or reporting period – for example, the approved budget may adopt a different classification or presentation format to the financial statements, may include only non-commercial activities of the entity, or may be a multiyear budget. A reconciliation would be necessary where there are presentation, timing or entity differences between the budget and the financial statements prepared on the same accounting basis.
- 1.9.45 ***The disclosure of comparative information in respect of the previous period in accordance with the requirements of this Standard is not required.***
- 1.9.46 This Standard requires a comparison of budget and actual amounts to be included in the financial statements of entities which make publicly available their approved budget(s). It does not require the disclosure of a comparison of actual amounts of the previous period with the budget of that previous period, nor does it require that the related explanations of differences between the actuals and budget of that previous period be disclosed in the financial statements of the current period.

Effective Date of Section 1.9 of Part 1

- 1.9.47 ***An entity shall apply Section 1.9 of this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after January 1, 2009. Earlier application is encouraged. If an entity applies Section 1.9 of this Standard for a period beginning before January 1, 2009 it shall disclose that fact.***

- 1.9.48 When an entity adopts this Standard subsequent to the effective date of Section 1.9 as specified in paragraph 1.9.47, paragraphs 1.9.1 to 1.9.46 of this Standard apply to the entity's annual financial statements covering periods beginning on or after the date of adoption.

1.10 Recipients of External Assistance

Definitions

- 1.10.1 *The following terms are used in this Standard with the meaning specified:*

Assigned External Assistance means any external assistance, including external assistance grants, technical assistance, guarantees or other assistance, received by an entity that is assigned by the recipient to another entity.

Bilateral External Assistance Agencies are agencies established under national law, regulation or other authority of a nation for the purpose of, or including the purpose of, providing some or all of that nation's external assistance.

External Assistance means all official resources which the recipient can use or otherwise benefit from in pursuit of its objectives.

Multilateral External Assistance Agencies are all agencies established under international agreement or treaty for the purpose of, or including the purpose of, providing external assistance.

Non-Governmental Organizations (NGOs) are all foreign or national agencies established independent of control by any government for the purpose of providing assistance to government(s), government agencies, other organizations or to individuals.

Official Resources means all loans, grants, technical assistance, guarantees or other assistance provided or committed under a binding agreement by multilateral or bilateral external assistance agencies or by a government, or agencies of a government, other than to a recipient of the same nation as the government or government agency providing, or committing to provide, the assistance.

Re-Lent External Assistance Loans means external assistance loans received by an entity that are lent by the recipient to another entity.

- 1.10.2 Different organizations may use different terminology for external assistance or classes of external assistance. For example, some organizations may use the term external aid or aid, rather than external assistance. In these cases, the different terminology is unlikely to cause confusion. However, in other cases, the terminology may be substantially different. In these cases, preparers, auditors and users of general purpose financial statements will need to consider

the substance of the definitions rather than just the terminology in determining whether the requirements of this Standard apply.

External Assistance

- 1.10.3 External assistance is defined in paragraph 1.10.1 as all official resources which the recipient can use or otherwise benefit from in pursuit of its objectives. Official resources as defined in paragraph 1.10.1 does not encompass assistance provided by non-governmental organizations (NGOs), even if such assistance is provided under a binding agreement. Assistance received from NGOs, whether in the form of cash donations or third party settlements, will be presented in the financial statements and disclosed in explanatory notes in accordance with the requirements of Sections 1.1 to 1.9 of Part 1 of this Standard. Paragraph 2.1.64 encourages, but does not require, application of the disclosures required by paragraphs 1.10.1 to 1.10.27 to assistance received from NGO's where practicable.
- 1.10.4 NGOs as defined in paragraph 1.10.1 are foreign or national agencies established independent of control by any government. In some rare cases, it may not be clear whether the donor organization is a bilateral or multilateral external assistance agency or a NGO, and therefore independent of control by any government. Where such a donor organization provides, or commits to provide, assistance under the terms of a binding agreement, the distinction between official resources as defined in this Standard and resources provided by a NGO may become blurred. In these cases, professional judgment will need to be exercised to determine whether the assistance received satisfies the definition of external assistance and, therefore, is subject to the disclosure requirements specified in this section.

Official Resources

- 1.10.5 Official resources are defined in paragraph 1.10.1 to be resources committed under a binding agreement by multilateral or bilateral external assistance agencies or governments or government agencies, other than to a recipient of the same nation as the provider of the assistance. Governments as referred to in the definition of official resources may include national, state, provincial or local governments in any nation. Therefore, assistance provided by, for example, a national government or state government agency of one nation to a state or local government of another nation is external assistance as defined in this Standard. However, assistance provided by a national or state government to another level of government within the same nation does not satisfy the definition of official resources, and therefore is not external assistance.

External Assistance Agreements

- 1.10.6 Governments seeking particular forms of external assistance may participate in formal meetings or rounds of meetings with donor organizations. These may

include meetings to discuss the government's macroeconomic plans and its development assistance needs, or bilateral discussions at governmental level regarding trade finance, military assistance, balance of payments and other forms of assistance. They may also include separate meetings to consider the country's emergency assistance needs as those needs arise. Initial discussions may result in statements of intent or pledges which are not binding on the government or the external assistance agency. However, subsequently binding agreements may be set in place to make available assistance loans or grants provided restrictions on access to the funds, if any, are met and agreed conditions or covenants are adhered to by the recipient entity.

1.10.7 External assistance agreements may provide for the entity to:

- (a) Draw down in cash the full proceeds of the loan or grant or a tranche of the loan or grant;
- (b) Seek reimbursement(s) for qualifying payments made by the entity to a third party settling in cash an obligation(s) of the entity, as defined by the loan or grant agreement; or
- (c) Request the external assistance agency to make payments directly to a third party settling in cash an obligation(s) of the recipient entity as defined by the loan or grant agreement, including an obligation of the recipient entity for goods or services provided or to be provided by a NGO.

External assistance agreements may also include the provision of goods or services in-kind to the recipient.

External Assistance Received

1.10.8 *The entity should disclose separately on the face of the Statement of Cash Receipts and Payments, total external assistance received in cash during the period.*

1.10.9 *The entity should disclose separately, either on the face of the Statement of Cash Receipts and Payments or in the notes to the financial statements, total external assistance paid by third parties during the period to directly settle obligations of the entity or purchase goods and services on behalf of the entity, showing separately:*

- (a) *Total payments made by third parties which are part of the economic entity to which the reporting entity belongs; and*
- (b) *Total payments made by third parties which are not part of the economic entity to which the reporting entity belongs.*

These disclosures should only be made when, during the reporting period, the entity has been formally advised by the third party or the recipient that such payment has been made, or has otherwise verified the payment.

- 1.10.10 ***Where external assistance is received from more than one provider, the significant classes of providers of assistance should be disclosed separately, either on the face of the Statement of Cash Receipts and Payments or in the notes to the financial statements.***
- 1.10.11 ***Where external assistance is received in the form of loans and grants, the total amount received during the period as loans and the total amount received as grants should be shown separately, either on the face of the Statement of Cash Receipts and Payments or in the notes to the financial statements.***
- 1.10.12 External assistance may be provided directly to the reporting entity in the form of cash. Alternatively, a third party may provide external assistance by settling an obligation of the reporting entity or purchasing goods and services for the benefit of the reporting entity. In some cases:
- (a) The third party may be part of the economic entity to which the reporting entity belongs – this will occur where, for example, external assistance in the form of cash is provided for the benefit of a program run by a particular department in a jurisdiction where the government manages the expenditure of its individual departments and other entities through a centralized treasury function or a “single account” arrangement. In these cases, the treasury or other central agency receives the external assistance and makes payments of amounts provided by way of external assistance on behalf of the department, after appropriate authorization and documentation from the department; or
 - (b) The third party may not be part of the economic entity to which the reporting entity belongs – this will occur where, for example, an aid agency makes a debt repayment to a regional development bank on behalf of a government agency, pays a construction company directly for building a road for a particular government agency rather than providing the funds directly to the government agency itself, or funds the operation of a health or education program of an independent provincial or municipal government by directly paying service providers and acquiring on behalf of the government the necessary supplies during the period.
- 1.10.13 Disclosure of the amount of external assistance received in the form of cash and in the form of third party payments made on behalf of the entity will indicate the extent to which the operations of the reporting entity are funded from taxes and/or internal sources, or are dependent upon external assistance. Consistent with the requirements of paragraph 1.3.24 of this Standard, external assistance paid by third parties should only be disclosed in the statement of Cash Receipts and Payments when the reporting entity has been formally advised that such payments have been made during the reporting period or otherwise verifies their

occurrence. Disclosure of the significant classes of external assistance received is also encouraged, but not required (see paragraph 2.1.66).

- 1.10.14 Disclosure of the significant classes of providers of assistance such as, for example, multilateral donors, bilateral donors, international assistance organizations, national assistance organizations or other major classes as appropriate for the reporting entity will identify the extent of the entity's dependence on particular classes of providers and will be relevant to an assessment of the sustainability of the assistance. This Standard does not require the disclosure of the identity of each provider of assistance or the amount of assistance each provides. However, disclosure of the amount provided by each provider in the currency provided is encouraged (see paragraph 2.1.70).
- 1.10.15 External assistance is often denominated in a currency other than the reporting currency of the entity. Cash receipts, or payments made by third parties on behalf of the entity arising from transactions in a foreign currency, will be recorded or reported in the entity's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the receipts or payments in accordance with paragraph 1.7.2 of this Standard.
- 1.10.16 National governments usually retain the exclusive right to enter into external assistance agreements with multilateral or bilateral external assistance agencies. In many of these cases, the project or activity is implemented by another entity. The national government may re-lend or assign the funds received to the other entity. The terms and conditions of the re-lent or assigned funds may be the same as received from the external assistance agency or may be different than initially received. In some cases, a small fee or interest spread is charged to cover the national government's administrative costs. An entity which enters into an external assistance agreement and passes the benefits as well as the terms and conditions of the agreement through to another entity by way of a subsidiary agreement will recognize or report the external assistance as it is received. It will also record payments to the second entity in accordance with its normal classification of payments adopted in the financial statements.
- 1.10.17 Where the initial recipient of a loan or grant passes the proceeds and the terms and conditions of the loan or grant through to another entity, the initial entity may simply be administering the loan or grant on behalf of the end user. Netting of transactions where the terms and conditions are substantially the same may be appropriate in the financial statements of the administrator, in accordance with the provisions of paragraph 1.3.13 of this Standard.

Undrawn External Assistance

- 1.10.18 *The entity should disclose in the notes to the financial statements the balance of undrawn external assistance loans and grants available at reporting date to fund future operations when, and only when, the amount of the loans or*

grants available to the recipient is specified in a binding agreement and the satisfaction of any substantial terms and conditions that determine, or affect access to, that amount is highly likely, showing separately in the reporting currency:

- (a) ***Total external assistance loans; and***
- (b) ***Total external assistance grants.***

Significant terms and conditions that determine, or affect access to, the amount of the undrawn assistance should also be disclosed.

- 1.10.19 The amount of external assistance currently committed under a binding agreement(s) but not yet drawn may be significant. In some cases, the amount of the assistance loan(s) or grant(s) is specified in a binding agreement and the satisfaction of any substantial conditions that need to be satisfied to access that amount is highly likely. This may occur in respect of undrawn balances of project funding for projects currently under development where conditions have been, and continue to be, satisfied and the project is anticipated to continue under the terms of the agreement. Where such undrawn balances are provided in a foreign currency, opening and closing balances will be determined by applying to the foreign currency amount the exchange rate on the reporting dates in accordance with the provisions of paragraph 1.7.3 of this Standard.
- 1.10.20 In some cases, a donor entity may express an intention to provide ongoing assistance to the reporting entity, but not specify in a binding agreement the amount of the assistance loan(s) or grant(s) to be provided in future periods – for example, this may occur where the amount of assistance to be provided is dependent on the annual budget of the donor nation or other sources of funding that may be secured by the recipient. In other cases, the amount of assistance may be specified but be subject to terms and conditions, the satisfaction of which cannot be assessed as being highly likely at the reporting date – for example, this may occur in respect of balance of payment assistance to be provided on achievement of specified performance criteria, or emergency assistance to be provided subject to the amount of assistance provided by other agencies. In these cases, disclosure of the undrawn amounts is not made. In some cases, professional judgment may need to be exercised in assessing whether the satisfaction of the substantial terms and conditions that determine, or effect access to, the external assistance is highly likely.

Receipt of Goods or Services

- 1.10.21 ***Where an entity elects to disclose the value of external assistance received in the form of goods or services, it should also disclose in the notes to the financial statements the basis on which that value is determined.***
- 1.10.22 Paragraph 2.1.90 of this Standard encourages an entity to disclose separately in the notes to the financial statements the value of external assistance received in

the form of goods or services. Paragraph 1.3.38 of this Standard explains that where encouraged disclosures are included in notes to the financial statements, they will need to be understandable and to satisfy the other qualitative characteristics of financial information. Where an entity elects to make such disclosures, it is required to disclose in the notes to the financial statements the basis on which that value is determined. Such disclosure will enable users to assess whether, for example, the value is determined by reference to donor valuation, fair value determined by reference to prices in the world or domestic markets, by management assessment or on another basis.

Disclosure of Debt Rescheduled or Cancelled

- 1.10.23 *An entity should disclose in the notes to the financial statements the amount of external assistance debt rescheduled or cancelled during the period, together with any related terms and conditions.*
- 1.10.24 An entity experiencing difficulty in servicing its external assistance debt may seek renegotiation of the terms and conditions of the debt or cancellation of the debt. Disclosure of the amount of external assistance debt rescheduled or cancelled, together with any related terms and conditions, will alert users of the financial statements that such renegotiation or cancellation has occurred. This will provide useful input to assessments of financial condition of the entity and changes therein.

Disclosure of Non Compliance with Significant Terms and Conditions

- 1.10.25 *An entity should disclose, in notes to the financial statements, significant terms and conditions of external assistance loan or grant agreements or guarantees that have not been complied with during the period when non compliance resulted in cancellation of the assistance or has given rise to an obligation to return assistance previously provided. The amount of external assistance cancelled or to be returned should also be disclosed.*
- 1.10.26 External assistance agreements will usually include terms and conditions that must be complied with for ongoing access to assistance funds, as well as some procedural terms and conditions.
- 1.10.27 The disclosures required by paragraph 1.10.25 will enable readers to identify the instances of non compliance that have adversely affected the funds that are available to support the entity's future operations. It will also provide input to assessments of whether re-establishment of compliance with the agreement may occur in the future. Disclosure of non compliance with significant terms and conditions in other cases is also encouraged, but not required (see paragraph 2.1.83).

Effective Date of Section 1.10 and Transitional Provisions

- 1.10.28 *Paragraphs 1.10.1 to 1.10.34 of this International Public Sector Accounting Standard become effective for annual financial statements covering periods beginning on or after 1 January 2009.*
- 1.10.29 *Entities are not required to disclose comparative figures for amounts disclosed in accordance with paragraphs 1.10.1 to 1.10.27 in the first year of application of paragraphs 1.10.1 to 1.10.34 of this Standard.*
- 1.10.30 *Entities are not required to disclose separately in the notes to the financial statements the balance of undrawn external assistance as specified in paragraph 1.10.18 for a period of two years from the date of first application of paragraphs 1.10.1 to 1.10.34 of this Standard.*
- 1.10.31 *When an entity applies the transitional provisions in paragraph 1.10.29 and 1.10.30, it should disclose that it has done so.*
- 1.10.32 In the first year of application of the requirements of paragraphs 1.10.1 to 1.10.27 of this Standard, an entity may not have readily available, or reasonable access to, the information necessary to enable it to satisfy the requirement to disclose comparative information. It may also not have the information necessary to enable it to disclose the closing balance of undrawn external assistance as required by paragraph 1.10.18.
- 1.10.33 Paragraph 1.4.16 of this Standard provides relief from the requirement to disclose comparative information for the previous period on initial application of the Standard. Some entities may have adopted the Cash Basis IPSAS prior to its amendment to include the requirements relating to disclosure of information by recipients of external assistance as specified in paragraphs 1.10.1 to 1.10.27. Paragraph 1.10.29 provides relief from the requirement to disclose comparative information about external assistance as specified in paragraphs 1.10.1 to 1.10.27 in this Standard in the first year of application of those paragraphs. Paragraph 1.10.30 provides relief from the requirement to apply paragraph 1.10.18 for a period of two years from initial application of that paragraph.
- 1.10.34 To ensure users are informed of the extent to which the requirements of this Standard have been complied with, paragraph 1.10.31 requires that entities that make use of these transitional provisions disclose that they have done so.

Appendix 1

Illustration of the Requirements of Part 1 of the Standard

This Appendix is illustrative only and does not form part of the Standard. It illustrates an extract of a Statement of Receipts and Payments and relevant note disclosures for a government that has received external assistance loans and grants during the current and preceding periods. Its purpose is to assist in clarifying the meaning of the standards by illustrating their application in the preparation and presentation of general purpose financial statements under the cash basis of accounting for:

- (a) ***A Government** which is a recipient of external assistance;*
- (b) ***A Government Entity** which controls its own bank account, and is not a recipient of external assistance; and*
- (c) ***A Government Department** which operates under a “single account” system such that a central entity administers cash receipts and payments on behalf of the Department, and is not a recipient of external assistance.*

APPENDIX 1A

CONSOLIDATED FINANCIAL STATEMENTS FOR GOVERNMENT A
CONSOLIDATED STATEMENT OF CASH RECEIPTS AND PAYMENTS
FOR YEAR ENDED

DECEMBER 31, 200X

(RECEIPTS ONLY)

	Note	← 2000X →		← 200X-1 →	
(in thousands of currency units)		Receipts/ (Payments) controlled by entity	Payments by third parties	Receipts/ (Payments) controlled by entity	Payments by third parties
RECEIPTS					
Taxation					
Income tax		X	—	X	—
Value-added tax		X	—	X	—
Property tax		X	—	X	—
Other taxes		<u>X</u>	<u>—</u>	<u>X</u>	<u>—</u>
		X	—	X	—
External Assistance 10					
Multilateral Agencies		X	X	X	X
Bilateral Agencies		<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>
		X	X	X	X
Other Grants and Aid		X	X	X	X
Other Borrowings					
Proceeds from borrowing	3	X	X		
Capital Receipts					
Proceeds from disposal of plant and equipment		X	-	X	—
Trading Activities					
Receipts from trading activities		X	-	X	—
Other receipts	4	<u>X</u>	<u>X</u>	<u>X</u>	<u>X</u>
Total receipts		X	X	X	X

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

	Note	200X		200X-1	
(in thousands of currency units)		Receipts/ (Payments) controlled by entity	Payments by third parties	Receipts/ (Payments) controlled by entity	Payments by third parties
PAYMENTS					
Operations					
Wages, salaries and employee benefits		(X)	(X)	(X)	(X)
Supplies and consumables		(X)	(X)	(X)	(X)
		(X)	(X)	(X)	(X)
Transfers					
Grants		(X)	–	(X)	–
Other transfer payments		(X)	=	(X)	=
		(X)	–	(X)	–
Capital Expenditures					
Purchase/construction of plant and equipment		(X)	(X)	(X)	(X)
Purchase of financial instruments		(X)	=	(X)	=
		(X)	(X)	(X)	(X)
Loan and Interest Repayments					
Repayment of borrowings		(X)	–	(X)	–
Interest payments		(X)	=	(X)	=
		(X)	–	(X)	–
Other payments	5	(X)	(X)	(X)	(X)
Total payments		(X)	(X)	(X)	(X)
Increase/(Decrease) in Cash		X	–	X	–
Cash at beginning of year	2	X	N/A*	X	N/A
Increase/(Decrease) in Cash		X	N/A	X	N/A
Cash at end of year	2	X	N/A	X	N/A

* N/A = Not applicable.

STATEMENT OF COMPARISON OF BUDGET AND ACTUAL AMOUNTS
For Government X for the Year Ended December 31, 200X
Budget Approved on the Cash Basis
(Classification of Payments by Functions)

(in thousands of currency units)	*Actual Amounts	Final Budget	Original Budget	** <i>Difference: Final Budget and Actual</i>
CASH INFLOWS				
Taxation	X	X	X	X
Aid agreements				
International agencies	X	X	X	X
Other grants and aid	X	X	X	X
Proceeds: borrowing	X	X	X	X
Proceeds: disposal of plant and equipment	X	X	X	X
Trading activities	X	X	X	X
Other receipts	X	X	X	X
Total receipts	X	X	X	X
CASH OUTFLOWS				
Health	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)
Public order/safety	(X)	(X)	(X)	(X)
Social protection	(X)	(X)	(X)	(X)
Defense	(X)	(X)	(X)	(X)
Housing and community amenities	(X)	(X)	(X)	(X)
Recreational, cultural and religion	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)
Total payments	(X)	(X)	(X)	(X)
NET CASH FLOWS	X	X	X	X

* Actual amounts encompass both cash and third party settlements.

** The "Difference..." column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

ADDITIONAL FINANCIAL STATEMENTS (OPTIONAL)

Additional financial statements may be prepared to provide details of amounts included in the consolidated statement of cash receipts and payments: for example, to disclose information by major fund groups or to disclose expenditures by major functions or programs, or to provide details of sources of borrowings. Columns disclosing budgeted amounts may also be included.

STATEMENT OF CASH RECEIPTS BY FUND CLASSIFICATION

(in thousands of currency units)	200X Receipts controlled by entity	200X-1 Receipts controlled by entity
RECEIPTS		
Consolidated Funds	X	X
Special Funds	X	X
Trading Funds	X	X
Loans	X	X
Total receipts	X	X

PROCEEDS OF BORROWINGS

(in thousands of currency units)	Note	200X		200X-1	
		Cash Receipts controlled by entity	Resulting from Payments by third parties	Receipts controlled by entity	Resulting from Payments by third parties
BORROWINGS					
Domestic Commercial Institution		X	—	X	—
Offshore Commercial Institution		X	—	X	—
Development Banks and Similar Lending Agencies		X	X	X	X
Total borrowings	3	X	X	X	X

STATEMENT OF PAYMENTS BY PROGRAMS/ACTIVITIES/FUNCTION OF GOVERNMENT

(in thousands of currency units)	← 200X →		← 200X-1 →	
	Payments controlled by entity	Payments by third parties	Payments controlled by entity	Payments by third parties
PAYMENTS/EXPENDITURE – Operating Account				
Education Services	X	X	X	X
Health Services	X	X	X	X
Social Security and Welfare	X	–	X	–
Defense	X	–	X	–
Public Order and Safety	X	X	X	X
Recreation, Culture and Religion	X	X	X	X
Economic Services	X	–	X	–
Other	X	X	X	X
Total payments/expenditure	X	X	X	X
PAYMENTS/EXPENDITURE – Capital Account				
Education Services	X	X	X	X
Health Services	X	X	X	X
Social Security and Welfare	X	–	X	–
Defense	X	–	X	–
Public Order and Safety	X	X	X	X
Recreation, Culture and Religion	X	X	X	X
Other	X	X	X	X
Total payments/expenditure	X	X	X	X
Total Operating and Capital Accounts	X	X	X	X

PUBLIC SECTOR ENTITY—WHOLE-OF-GOVERNMENT

Notes to the Financial Statements

1. Accounting Policies

Basis of preparation

The financial statements have been prepared in accordance with Cash Basis IPSAS *Financial Reporting Under The Cash Basis of Accounting*.

The accounting policies have been applied consistently throughout the period.

Reporting entity

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

- (i) Central government ministries; and
- (ii) Government business enterprises and trading funds that are under the control of the entity.

The consolidated financial statements include all entities controlled during the year. A list of significant controlled entities is shown in Note 7 to the financial statements.

Payments by Third Parties

The government also benefits from goods and services purchased on its behalf as a result of cash payments made by third parties during the period by way of loans and contributions. The payments made by the third parties do not constitute cash receipts or payments by the government but do benefit the government. They are disclosed in the *Payments by third parties* column in the Consolidated Statement of Cash Receipts and Payments and other financial statements.

Reporting currency

The reporting currency is (currency of Country A).

2. Cash

Cash comprises cash on hand, demand deposits and cash equivalents. Demand deposits and cash equivalents consist of balances with banks and investments in short-term money market instruments.

Cash included in the statement of cash receipts and payments comprise the following amounts:

	(in thousands of currency units)	200X	200X-1
Cash on hand and balances with banks		X	X
Short-term investments		X	X
		<u>X</u>	<u>X</u>

Included in the amount stated above is X currency units provided by the International Agency XX that is restricted to the construction of road infrastructure.

3. **Borrowings**

Borrowings comprise cash inflows from banks, similar lending agencies and commercial institutions and amounts owing in respect of non-cash assistance provided by third parties.

4. **Other Receipts**

Included in other receipts are fees, fines, penalties and miscellaneous receipts.

5. **Other Payments/Expenditure**

Included in other payments are dividends, distributions paid, legal settlements of lawsuits and miscellaneous payments.

6. **Undrawn Borrowing Facilities Other than Undrawn External Assistance**

(See note 10 for undrawn external assistance)

	(in thousands of currency units)	200X	200X-1
Movement in Undrawn Borrowing Facilities			
Undrawn borrowing facilities at 1.1.0X		X	X
Additional loan facility		X	X
Total available		<u>X</u>	<u>X</u>
Amount drawn		(X)	(X)
Facility closure/cancellations		<u>(X)</u>	<u>(X)</u>
Undrawn borrowing facilities at 31.12.0X.		<u>X</u>	<u>X</u>

(in thousands of currency units) **200X** **200X–
1**

Undrawn Borrowing Facilities

Commercial Financial Institutions	X	X
Total undrawn borrowing facilities	X	X

7. Significant Controlled Entities

Entity	Jurisdiction
Entity A	X
Entity B	X
Entity C	X
Entity D	X

8. Authorization Date

The financial statement was authorized for publication on XX *Month* 200X+1 by Mr YY, the Treasurer of Country A.

9. Original and Final Approved Budget and Comparison of Actual and Budget Amounts

The approved budget is developed on the same accounting basis (cash basis), same classification basis, and for the same period (from 1 January 200X to 31 December 200X) as for the financial statements. It encompasses the same entities as the consolidated financial statement – these are identified in Note 7 above.

The original budget was approved by legislative action on (date) and a supplemental appropriation of XXX for disaster relief support was approved by legislative action on (date) due to the earthquake in the Northern Region on (date). The original budget objectives and policies, and subsequent revisions are explained more fully in the Operational Review and Budget Out-turn Report issued in conjunction with the financial statements.

The excess of actual expenditure over the final budget of 15% (25% over original budget) for the Health function was due to expenditures above the level approved by legislative action in response to the earthquake. There were no other material differences.

Alternative Note 9 when budget and financial statements are prepared on a different basis

9. Original and Final Approved Budget and Comparison of Actual and Budget Amounts

The budget is approved on a modified cash basis by functional classification. The approved budget covers the fiscal period from January 1, 200X to December 31, 200X and includes all entities within the general government sector. The general government sector includes all government departments – these are identified in Note 7 above.

The original budget was approved by legislative action on (date) and a supplemental appropriation of XXX for disaster relief support was approved by legislative action on (date) due to the earthquake in the Northern Region on (date). The original budget objectives and policies, and subsequent revisions are explained more fully in the Operational Review and Budget Out-turn Report issued in conjunction with the financial statements.

The excess of actual expenditure over the final budget of 15% (25% over original budget) for the Health function was due to expenditures above the level approved by legislative action in response to the earthquake. There were no other material differences between the final approved budget and the actual amounts.

The budget and the accounting bases differ. The financial statements for the whole-of-government are prepared on the cash basis using a classification based on the nature of expenses in the statement of financial performance. The financial statements are consolidated statements which include all controlled entities, including government business enterprises for the fiscal period from January 1, 20XX to December 31 20XX. The budget is approved on the modified cash basis by functional classification and deals only with the general government sector which excludes government business enterprises and certain other non-market government entities and activities.

The amounts in the statement of cash receipts and payments were adjusted to be consistent with the modified cash basis and reclassified by functional classification to be on the same basis as the final approved budget. In addition, adjustments to amounts in the statement of cash receipts and payments for timing differences associated with the continuing appropriation and differences in the entities covered (government business enterprises and other entities) were made to express the actual amounts on a comparable basis to the final approved budget.

A reconciliation between the actual inflows and outflows as presented in the statement of comparison of budget and actual amounts and the amounts of total cash receipts and total cash payments reported in the statement of cash receipts and payments for the year ended December 31, 20XX is presented below.

	Total inflows	Total outflows
Actual Amount on Comparable Basis as Presented in the Budget and Actual Comparative Statement	X	X
Basis Differences	X	X
Timing Differences	–	–
Entity Differences	X	X
Total Cash receipts	X	
Total Cash Payments		X

The financial statements and budget documents are prepared for the same period. There is an entity difference: the budget is prepared for the general government sector and the financial statements consolidate all entities controlled by the government. There is also a basis difference: the budget is prepared on a cash basis and the financial statements on the modified cash basis.

This reconciliation could be included on the face of the Statement of Comparison of Budget and Actual Amounts or as a note disclosure.

10. External Assistance

Payments by Third Parties

All payments made by third parties are made by third parties which are not part of the economic entity.

External Assistance

External assistance was received in the form of loans and grants from multilateral and bilateral donor agencies under agreements specifying the purposes for which the assistance will be utilized. The following amounts are presented in the reporting currency of the entity.

	<u>200X</u> Total	<u>200X-1</u> Total
Loan Funds		
Multilateral Agencies	X	X
Bilateral Agencies	X	X
Total	X	X
Grant Funds		
Multilateral Agencies	X	X
Bilateral Agencies	X	X
Total	X	X
Total External Assistance	X	X

Non Compliance with significant terms and conditions and rescheduled and cancelled debt

There have been no instances of non compliance with terms and conditions which have resulted in cancellation of external assistance loans.

External assistance grants of X domestic currency units were cancelled during the reporting period. The cancellation resulted from over estimation of the cost of specified development projects and consequentially expenditure of an amount less than that committed for the period by the donor entity.

Undrawn External Assistance

Undrawn external assistance loans and grants at reporting date are amounts specified in a binding agreement which relate to funding for projects currently under development, where conditions have been satisfied, and their ongoing satisfaction is highly likely, and the project is anticipated to continue to completion.

	Loans 200X	Grants 200X	Loans 200X-1	Grants 200X-1
Closing balance in reporting currency	X	X	X	X

The significant terms and conditions that determine or affect access to the amount of undrawn assistance relate to the achievement of the following specified construction targets for development of medical and education infrastructure: (Entity to identify significant construction targets).

APPENDIX 1B

GOVERNMENT ENTITY AB

(THIS ENTITY CONTROLS ITS OWN BANK ACCOUNT AND ALSO BENEFITS FROM PAYMENTS MADE BY THIRD PARTIES.)

CONSOLIDATED STATEMENT OF CASH RECEIPTS AND PAYMENTS
FOR YEAR ENDED DECEMBER 31, 200X

	Note	200X			200X-1		
		Receipts/ (Payments) controlled by entity	Payments by other government entities	Payments by external third parties	Receipts/ (Payments) controlled by entity	Payments by other government entities	Payments by external third parties
(in thousands of currency units)							
RECEIPTS							
Authorized allocations/Appropriations		X	X	—	X	X	—
Other receipts		X	—	—	X	—	—
Grants/Assistance		—	—	X	—	—	X
Total receipts		X	X	X	X	X	X
PAYMENTS							
Wages, salaries and employee benefits		(X)	—	—	(X)	—	—
Rent		(X)	(X)	—	(X)	(X)	—
Capital Expenditure		(X)	(X)	(X)	(X)	(X)	(X)

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

	Note	200X			200X-1		
		Receipts/ (Payments) controlled by entity	Payments by other government entities	Payments by external third parties	Receipts/ (Payments) controlled by entity	Payments by other government entities	Payments by external third parties
(in thousands of currency units)							
Transfers	3	(X)	(X)	(X)	(X)	(X)	(X)
Total payments		(X)	(X)	(X)	(X)	(X)	(X)
Increase/(Decrease) in Cash		X	X	(X)	X	(X)	X
Cash at beginning of year	2	X	N/A*	N/A	X	N/A	N/A
Increase/(Decrease) in Cash		X	N/A	N/A	X	N/A	N/A
Cash at end of year	2	X	N/A	N/A	X	N/A	N/A

* N/A = Not Applicable.

ADDITIONAL FINANCIAL STATEMENTS (OPTIONAL)

Additional financial statements may be prepared, for example, to disclose budget information by major fund groups if applicable or to display expenditures by major functions. An example of a statement by function is included below.

STATEMENT OF PAYMENTS BY FUNCTION

	Note	200X			200X-1		
		Payments controlled by entity	Payments by other government entities	Payments by external third parties	Payments controlled by entity	Payments by other government entities	Payments by external third parties
(in thousands of currency units)							
PAYMENTS/EXPENDITURE							
Program I		(X)	(X)	(X)	(X)	(X)	(X)
Program II		(X)	(X)	(X)	(X)	(X)	(X)
Program III		(X)	(X)	(X)	(X)	(X)	(X)
Program IV		(X)	(X)	(X)	(X)	(X)	(X)
Other payments/expenditure		(X)	(X)	(X)	(X)	(X)	(X)
Total payments/expenditure		(X)	(X)	(X)	(X)	(X)	(X)

GOVERNMENT ENTITY AB

Notes to the Financial Statements

1. Accounting Policies

Basis of preparation

The financial statements have been prepared in accordance with Cash Basis IPSAS “Financial Reporting Under the Cash Basis of Accounting.”

The accounting policies have been applied consistently throughout the period.

Reporting entity

The financial statements are for a public sector entity (Government Entity AB). The financial statements encompass the reporting entity as specified in the relevant legislation (Public Finance Act 20XX). This comprises Government Entity AB and its controlled entities. Government Entity AB is controlled by the national government of Country A.

Government Entity AB’s principal activity is to provide [identify type of] services to constituents. The Entity controls its own bank account. Appropriations and other cash receipts are deposited into its bank accounts.

Payments by other government entities

The Entity benefits from payments made by its controlling entity (Government A) and other government entities on its behalf.

Payments by external third parties

The Entity also benefits from payments made by external third parties (entities external to the economic entity) for goods and services. These payments do not constitute cash receipts or payments of the Entity, but do benefit the Entity. They are disclosed in the *Payments by external third parties* column in the Statement of Cash Receipts and Payments and in other financial statements.

Reporting currency

The reporting currency is (currency of Country A).

2. Cash

Cash comprises cash on hand, demand deposits and cash equivalents. Demand deposits and cash equivalents comprise balances with banks and investments in short-term money market instruments.

Amounts appropriated to the Entity are deposited in the Entity’s bank account and are controlled by the entity. All borrowings are undertaken by a central finance entity.

Receipts from exchange transactions are deposited in trading fund accounts controlled by the Entity. They are transferred to consolidated revenue at year end.

Cash included in the statement of cash receipts and payments comprise the following amounts:

(in thousands of currency units)	200X	200X-1
Cash on hand and balances with banks	X	X
Short-term investments	X	X
	<u>X</u>	<u>X</u>

3. Transfers

Amounts are transferred to eligible recipients in accordance with operating mandate and authority of the entity.

4. Significant Controlled Entities

Entity	Jurisdiction
Entity A	X
Entity B	X

5. Authorization Date

The financial statements were authorized for issue on XX *Month* 200X+1 by Mr YY, Minister of XXXXX for Entity AB.

APPENDIX 1C

GOVERNMENT DEPARTMENT AC

(THE GOVERNMENT OPERATES A CENTRALIZED SINGLE ACCOUNT
SYSTEM– THE ENTITY DOES NOT CONTROL AMOUNTS
APPROPRIATED FOR ITS USE.)

STATEMENT OF CASH RECEIPTS AND PAYMENTS
FOR YEAR ENDED 31 DECEMBER 200X

	Note	200X		200X-1	
(in thousands of currency units)		Treasury Account/ Single Control Account	Payments by external third parties	Treasury Account/ Single Control Account	Payments by external third parties
RECEIPTS					
Allocations/ Appropriations	2	X	–	X	–
Other receipts		X	–	X	–
Assistance		–	X	–	X
Total receipts		X	X	X	X
PAYMENTS					
Wages, salaries and employee benefits		(X)	–	(X)	–
Rent		(X)	–	(X)	–
Capital Expenditure		(X)	(X)	(X)	(X)
Transfers	3	(X)	(X)	(X)	(X)
Total payments		(X)	(X)	(X)	(X)

ADDITIONAL FINANCIAL STATEMENTS (OPTIONAL)

Additional financial statements may be prepared, for example, to disclose budget information by major fund groups if applicable or to display expenditures by major functions or payments. An example of a statement by function is included below.

STATEMENT OF PAYMENTS BY FUNCTION

	Note	← 200X →		← 200X-1 →	
		Treasury Account/ Single Control Account	Payments by external third parties	Treasury Account/ Single Control Account	Payments by external third parties
(in thousands of currency units)					
PAYMENTS					
Program I		X	X	X	X
Program II		X	X	X	X
Program III		X	X	X	X
Program IV		X	X	X	X
Other payments		X	X	X	X
Total payments		X	X	X	X

GOVERNMENT DEPARTMENT AC

Notes to the Financial Statements

1. Accounting Policies

Basis of preparation

The financial statements have been prepared in accordance with Cash Basis IPSAS “Financial Reporting Under The Cash Basis of Accounting.”

The accounting policies have been applied consistently throughout the period.

Reporting entity

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

Government Department AC’s principal activity is to provide services to constituents.

Government Department AC does not operate its own bank account. The Government operates a centralized treasury function which administers cash expenditures incurred by all departments during the financial year. Payments made on this account in respect of the Department are disclosed in the Treasury Account column in the Statement of Cash Receipts and Payments and other financial statements.

Payments by external third parties

Government Department AC benefits from goods and services purchased on its behalf as a result of cash payments made by third parties external to the Government during the reporting period. The payments made by the third parties do not constitute cash receipts or payments of the Department but do benefit the Department. They are disclosed in the *Payments by external third parties* column in the Statement of Cash Receipts and Payments and other financial statements.

Reporting currency

The reporting currency is (currency of Country A).

2. Appropriations

Amounts appropriated to Government Department AC are managed through a central account administered by the Office of the Treasury. These amounts are not controlled by Department AC but are deployed on the Department’s behalf by the central account administrator on presentation of appropriate documentation and authorization. All borrowings are undertaken by a central finance entity. The amount reported as allocations/appropriations in the statement of cash receipts and payments is the amount the Office of the Treasury has expended for the benefit of Department AC (the amount “drawn down”).

3. Transfers

Amounts are transferred to eligible recipients in accordance with the operating mandate and authority of Department AC.

4. Authorization Date

The financial statements were authorized on XX *Month* 200X+1 by Mr YY, Minister of XXXXX for Government Department AC.

PART 2: FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING—ENCOURAGED ADDITIONAL DISCLOSURES

This part of the Standard is not mandatory. It sets out encouraged additional disclosures for reporting under the cash basis. It should be read together with Part 1 of this Standard, which sets out the requirements for reporting under the cash basis of accounting. The encouraged disclosures, which have been set in italic, should be read in the context of the commentary paragraphs in this part of the Standard, which are in plain type.

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING PART 2: ENCOURAGED ADDITIONAL DISCLOSURES

2.1 Encouraged Additional Disclosures

Definitions

2.1.1 *The following terms are used in this part of the Standard with the meanings specified:*

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

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

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

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

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

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

Extraordinary items are (for the purposes of this Standard) cash flows that arise from events or transactions that are clearly distinct from the ordinary activities of the entity, are not expected to recur frequently or regularly and are outside the control or influence of the entity.

A financial asset is any asset that is:

- (a) Cash;
- (b) A contractual right to receive cash or another financial asset from another entity;
- (c) A contractual right to exchange financial instruments with another entity under conditions that are potentially favorable; or
- (d) An equity instrument of another entity.

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

Ordinary activities are any activities which are undertaken by an entity as part of its service delivery or trading activities. Ordinary activities include such related activities in which the entity engages in furtherance of, incidental to, or arising from these activities.

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

Terms defined in Part 1 of this Standard are used in this part of the Standard with their defined meaning.

Future Economic Benefits or Service Potential

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

Going Concern

- 2.1.3 *When preparing the financial statements of an entity, those responsible for the preparation of the financial statements are encouraged to make an assessment of the entity's ability to continue as a going concern. When those responsible for the preparation of the financial statements are aware, in making their assessment, of material uncertainties related to events or conditions which may cast significant doubt upon the entity's ability to continue as a going concern, the disclosure of those uncertainties is encouraged.*
- 2.1.4 The determination of whether an entity is a going concern is primarily relevant for individual entities rather than for the government as a whole. For individual entities, in assessing whether the entity is a going concern, those responsible for the preparation of the financial statements:
- (a) Will need to take into account all available information for the foreseeable future which will include, but will not necessarily be limited to, twelve months from the approval of the financial statements; and
 - (b) May need to consider a wide range of factors surrounding current and expected performance, potential and announced restructurings of organizational units, estimates of receipts or the likelihood of continued

government funding, and potential sources of replacement financing before it is appropriate to conclude that the entity is a going concern.

- 2.1.5 There may be circumstances where the usual going concern tests of liquidity and solvency as applied to business enterprises appear unfavorable, but other factors suggest that the entity is nonetheless a going concern. For example:
- (a) In assessing whether the government is a going concern, the power to levy rates or taxes may enable some entities to be considered as a going concern even though their cash payments may exceed their cash receipts for extended periods; and
 - (b) For an individual entity, an assessment of its cash flows for a reporting period may suggest that the entity is not a going concern. However, there may be multi-year funding agreements in place with the government that will ensure the continued operation of the entity.

Extraordinary Items

- 2.1.6 *An entity is encouraged to separately disclose the nature and amount of each extraordinary item. The disclosure may be made on the face of the statement of cash receipts and payments, or in other financial statements or in the notes to the financial statements.*
- 2.1.7 Extraordinary items are characterized by the fact that they arise from events or transactions that are distinct from an entity's ordinary activities, are not expected to recur frequently or regularly and are outside the control or influence of the entity. Accordingly, extraordinary items are rare, unusual and material.

Distinct from Ordinary Activities

- 2.1.8 Whether an event or transaction is clearly distinct from the ordinary activities of the entity is determined by the nature of the event or transaction in relation to the activities ordinarily carried on by the entity rather than by the frequency with which such events are expected to occur. An event or transaction may be extraordinary for one entity or level of government, but not extraordinary for another entity or level of government, because of the differences between their respective ordinary activities. In the context of whole-of-government reporting, extraordinary items will be extremely rare.

Not Expected to Recur in the Foreseeable Future

- 2.1.9 The event or transaction will be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates. The nature of extraordinary items is such that they would not normally be anticipated at the beginning of a reporting period and therefore would not be included in a budget. Inclusion of an item in a budget suggests that the occurrence of the specific item is foreseen and therefore not extraordinary.

Outside the Control or Influence of the Entity

- 2.1.10 The event or transaction will be outside the control or influence of the entity. A transaction or event is presumed to be outside the control or influence of an entity if the decisions or determinations of the entity do not normally influence the occurrence of that transaction or event.

Identifying Extraordinary Items

- 2.1.11 Whether or not an item is extraordinary will be considered in the context of the entity's operating environment and the level of government within which it operates. Judgment will be exercised in each case.
- 2.1.12 Examples of cash flows associated with events or transactions that may, although not necessarily, give rise to extraordinary items for some public sector entities or levels of government are:
- (a) Short-term cash flows associated with the provision of services to refugees where the need for such services was unforeseen at the beginning of the period, outside the ordinary scope of activities for the entity and outside the control of the entity. If such services were predictable or occurring in more than one reporting period they would not generally be classified as extraordinary; and
 - (b) The cash flows associated with the provision of services following a natural or man-made disaster, for example, the provision of shelter to homeless people following an earthquake. In order for a particular earthquake to qualify as an extraordinary event it would need to be of a magnitude that would not normally be expected in either the geographic area in which it occurred or the geographic area associated with the entity, and the provision of emergency services or the restoration of essential services would need to be outside the scope of ordinary activities of the entity concerned. Where an entity has responsibility for providing assistance to those affected by natural disasters, the costs associated with this activity would not generally meet the definition of an extraordinary item.
- 2.1.13 The restructuring of activities is an example of an event which would normally not be extraordinary for either an individual public sector entity or the whole-of-government entity which incorporates that government body. All three criteria within the definition of an extraordinary item must be satisfied before an item can be classified as extraordinary. A restructuring may clearly be distinct from the ordinary activities of the entity. However, at the whole-of-government level, restructuring may occur frequently. More importantly, restructuring is usually within the control or influence of a whole-of-government entity. It is only in circumstances where the restructuring is imposed by another level of government or by an external regulator or other external authority that it could

be classified as outside the control or influence of the whole-of-government entity.

- 2.1.14 The disclosure of the nature and amount of each extraordinary item may be made on the face of the statement of cash receipts and payments or other financial statements that might be prepared or in the notes to those financial statements. An entity may also decide to disclose only the total amount of extraordinary items on the face of the statement of cash receipts and payments and the details in the notes.

Administered Transactions

- 2.1.15 *An entity is encouraged to disclose in the notes to the financial statements, the amount and nature of cash flows and cash balances resulting from transactions administered by the entity as an agent on behalf of others where those amounts are outside the control of the entity.*

- 2.1.16 The cash flows associated with transactions administered by an entity acting as an agent on behalf of others may not pass through a bank account controlled by the reporting entity. In these cases, the entity cannot use, or otherwise benefit from, the cash it administers in the pursuit of its own objectives. These cash flows are not controlled by the entity and therefore are not included in the totals shown on the face of the statement of cash receipts and payments or other financial statements that might be prepared. However, disclosure of the amount and nature of these transactions by major type is encouraged because it provides useful information on the scope of the entity's activities and it is relevant for an assessment of an entity's performance.

- 2.1.17 Where such cash receipts and payments pass through a bank account controlled by the entity, they are treated as cash flows and balances of the entity itself and included in the totals shown on the face of the statement of cash receipts and payments. Paragraph 1.3.13(a) of Part 1 of this Standard permits such cash receipts and payments to be reported on a net basis. Paragraphs 2.1.18 to 2.1.22 below provide guidance on the cash receipts, payments and balances that:

- (a) May be controlled by a government or government entity and will be reported in the statement of cash receipts and payments in accordance with Part 1 of this Standard; and
- (b) Are administered transactions which will not be included on the face of the statement of cash receipts and payments or other financial statements that might be prepared but for which disclosure is encouraged.

Revenue Collection

- 2.1.18 Public sector entities may control cash or administer cash receipts or payments on behalf of the government or other governments or government entities. For example, a government Department of Taxation (or revenue collection agency) may be established with its own bank account and provided with an

appropriation to fund its operations. The operations of the Department will include administering certain aspects of the Taxation Act and may encompass the collection of taxes on behalf of the government.

- 2.1.19 A Department of Taxation can use cash appropriated to it and deposited in a bank account which it controls to achieve its operating objectives as mandated, and can exclude others from using or benefiting from that cash. In these cases, the Department will control the cash appropriated for its own use. However, the cash the Department collects on behalf of the government through its tax collection activities is usually deposited in a specified government trust fund or transferred to a government bank account administered by the Treasury or similar department. In these circumstances, the cash collected cannot be used to support achievement of the objectives of the Department of Taxation, or otherwise deployed at the discretion of the Department's management without specific appropriation or other authorization by the government or relevant body. Therefore, the cash collected is not controlled by the Department of Taxation and would not form part of the cash receipts or cash balances of the Department. As a consequence of a government decision, some of the amounts collected may be appropriated or otherwise allocated for use by the Department. However, it is the government's decision to authorize the expenditure of the funds by the Department of Taxation, rather than the collection of the cash, that gives rise to the control.
- 2.1.20 Similar circumstances may arise when one government, for example a state or local government, collects cash on behalf of another government (such as a national government). In these cases, the government is acting as an agent for others in the collection of cash. The cash that arises as a result of managing transactions as an agent for others would not usually be deposited in a bank account of the collection agency and therefore would not form part of the cash receipts, cash payments or cash balances of the reporting entity.

“Pass-through” Cash Flows

- 2.1.21 In some cases, the administrative arrangements in place in respect of the revenue collection activities a government or government entity undertakes as an agent of another party may provide for the cash collected to be initially deposited in the entity's own bank account before it is transferred to the ultimate recipient. Cash flows arising as a consequence of these transactions are sometimes termed “pass-through” cash flows. In these cases, the entity will:
- (a) Control the cash it collects in its capacity as an agent for the, usually short, period the cash is deposited in the entity's bank account prior to transfer to third parties;
 - (b) Usually benefit from any interest arising from amounts deposited in interest bearing accounts prior to its transfer to the other entity; and

- (c) Have an obligation to transfer the cash collected to third parties in accordance with legislative requirements or administrative arrangements.

When cash inflows from administered transactions pass through a bank account controlled by the reporting entity, the cash receipts, cash transfers and cash balances arising from the collection activity will be included in the entity's statement of cash receipts and payments in accordance with paragraph 1.3.4(a)(i) of Part 1 of this Standard. Paragraph 1.3.13(a) of Part 1 of this Standard specifies that cash receipts and payments which arise from transactions the entity administers on behalf of other parties and which are recognized in the financial statements may be reported on a net basis.

Transfer Payments

- 2.1.22 Consistent with a government's objectives and with legislation or other authority, amounts appropriated to a government entity (a department, agency or similar) may include amounts to be transferred to third parties in respect of, for example, unemployment benefits, age or invalid pensions, family allowances and other social security and community benefit payments. In some cases, these amounts will pass through a bank account controlled by the entity. Where this occurs, the entity will recognize the cash appropriated for transfer during the reporting period as a cash receipt, the amounts transferred during that reporting period as a cash payment and any amounts held at the end of the reporting period for transfer in the future as part of closing balance of cash.

Disclosure of Major Classes of Cash Flows

- 2.1.23 *An entity is encouraged to disclose, either on the face of the statement of cash receipts and payments or other financial statements or in the notes to those statements:*
 - (a) *An analysis of total cash payments and payments by third parties using a classification based on either the nature of the payments or their function within the entity, as appropriate; and*
 - (b) *Proceeds from borrowings. In addition, the amount of borrowings may be further classified into type and source.*
- 2.1.24 The sub-classifications encouraged in paragraph 2.1.23(a) may be presented on the face of the statement of cash receipts and payments in accordance with the requirements of paragraphs 1.3.12 and 1.3.24 of Part 1 of this Standard. Where a different classification basis is adopted in the statement of cash receipts and payments, additional disaggregated disclosures reflecting the encouragement in paragraph 2.1.23(a) above is encouraged either as a separate statement or by way of note.
- 2.1.25 Cash payment items and payments by third parties may be further sub-classified in order to enhance accountability by identifying the major purposes for which

the payments are made. They may also be sub-classified in order to highlight the costs and cost recoveries of particular programs, activities or other relevant segments of the reporting entity. An entity is encouraged to present this information in at least one of the following two ways.

- 2.1.26 The first method is referred to as the nature of payments method. Payments are aggregated in the statement of cash receipts and payments according to their nature (for example, purchases of materials, transport costs, wages and salaries), and are not reallocated amongst various functions within the entity. An example of a classification using the nature of payments method is as follows:

	Cash payments	Payments by third parties
Wages and salaries	(X)	(X)
Transport costs	(X)	(X)
Capital acquisitions	(X)	(X)
Borrowing costs	(X)	(X)
Other	(X)	(X)
Total payments	<u>(X)</u>	<u>(X)</u>

- 2.1.27 The second method, referred to as the functional method of classification, classifies payments according to the program or purpose for which they were made. This presentation often provides more relevant information to users, although the allocation of payments to functions can be arbitrary and may involve considerable judgment. An example of a functional classification of cash payments is as follows:

	Cash payments	Payments by third parties
Health services	(X)	(X)
Education services	(X)	(X)
Capital acquisitions	(X)	(X)
Borrowing costs	(X)	(X)
Other	(X)	(X)
Total payments	<u>(X)</u>	<u>(X)</u>

- 2.1.28 Under this method, the cash payments associated with the main functions undertaken by the entity are shown separately. In this example, the entity has functions related to the provision of health services and education services. The entity would present cash payment line items for each of these functions.
- 2.1.29 Entities classifying cash payments by function are encouraged to disclose additional information on the nature of payments, including payments made for salaries and other employee benefits.

2.1.30 Paragraph 1.3.12 of Part 1 of this Standard requires the disclosure of total cash receipts of the entity showing separately a sub-classification of total cash receipts using a classification basis appropriate to the entity's operations. The sub-classification of cash receipts into appropriate classes will depend upon the size, nature and function of the amounts involved. In addition to disclosure of the amount of receipts from external assistance and borrowings, the following sub-classifications may be appropriate:

- (a) Receipts from taxation (these may be further sub-classified into types of taxes);
- (b) Receipts from fees, fines, penalties and licenses;
- (c) Receipts from exchange transactions including receipts from the sale of goods and services and user charges (where these are classified as exchange transactions);
- (d) The purposes for which external assistance grants and loans are provided, the providers of that assistance and the amount provided;
- (e) Receipts from other grants, transfers, or budget appropriations (possibly classified by source and purpose);
- (f) Receipts from interest and dividends; and
- (g) Receipts from gifts and donations.

Related Party Disclosures

2.1.31 *An entity is encouraged to disclose in the notes to the financial statements information required by International Public Sector Accounting Standard IPSAS 20, "Related Party Disclosures."*

2.1.32 IPSAS 20, in the accrual based series of IPSASs, defines related parties and other relevant terms, requires the disclosure of related party relationships where control exists and requires the disclosure of certain information about related party transactions, including information about aggregate remuneration of key management personnel.

Disclosure of Assets, Liabilities and Comparison with Budgets

2.1.33 *An entity is encouraged to disclose in the notes to the financial statements:*

- (a) *Information about the assets and liabilities of the entity; and*
- (b) *If the entity does not make publicly available its approved budget, a comparison with budgets*

2.1.34 Governments and government entities control significant resources in addition to cash and deploy those resources in the achievement of service delivery objectives. They also borrow to fund their activities, incur other debts and liabilities in the course of their operations and make commitments to expend

money in the future on the acquisition of capital assets. Non-cash assets and liabilities will not be reported on the face of the statement of cash receipts and payments or other financial statements that might be prepared under the cash basis of accounting. However, governments maintain records of, and monitor and manage, their debt and other liabilities and their non-cash assets. The disclosure of information about assets and liabilities and the costs of particular programs and activities will enhance accountability and is encouraged by this Standard.

2.1.35 Entities that make such disclosures are encouraged to identify assets and liabilities by type, for example, by classifying:

- (a) Assets as receivables, investments or property plant and equipment; and
- (b) Liabilities as payables, borrowings by type or source and other liabilities.

While such disclosures may not be comprehensive in the first instance, entities are encouraged to progressively develop and build on them. In order to comply with the requirements of paragraphs 1.3.5 and 1.3.37 of Part 1 of this Standard, these disclosures will need to comply with qualitative characteristics of financial information and should be clearly described and readily understood. Accrual basis IPSASs including IPSAS 13, “Leases,” IPSAS 17, “Property, Plant and Equipment” and IPSAS 19, “Provisions, Contingent Liabilities and Contingent Assets” can provide useful guidance to entities disclosing additional information about assets and liabilities.

Comparison with Budgets

2.1.36 Public sector entities are typically subject to budgetary limits in the form of appropriations or other budgetary authority which may be given effect through authorizing legislation. One of the objectives of financial reporting by public sector entities is to report on whether cash was obtained and used in accordance with the legally adopted budget. In some jurisdictions, this requirement is reflected in legislation. Entities which make publicly available their approved budgets are required to comply with the requirements of paragraphs 1.9.1 to 1.9.48 of Part 1 of this Standard. This Standard encourages other entities (that is, entities which do not make publicly available their approved budgets) to include in their financial statements the disclosure of a comparison of actual with the budgeted amounts for the reporting period where the financial statements and the budget are on the same basis of accounting. Reporting against budgets for these other entities may be presented in different ways, including:

- (a) The preparation of a note with separate columns for budgeted amounts and actual amounts. A column showing any variances from the budget or appropriation may also be presented for completeness; and

- (b) Disclosure that the budgeted amounts have not been exceeded. If any budgeted amounts or appropriations have been exceeded, or payments made without appropriation or other form of authority, then details may be disclosed by way of note to the relevant item in the financial statements.
- 2.1.37 *Entities which disclose in their financial statements a comparison of actual with budgeted amounts are encouraged to include in the financial statements a cross reference to reports which include information about service achievements.*
- 2.1.38 *Entities which adopt multi-period budgets are encouraged to provide additional note disclosures about the relationship between budget and actual amounts during the budget period.*
- 2.1.39 Additional budget information, including information about service achievements, may be presented in documents other than financial statements. Entities which disclose in their financial statements a comparison of actual with budgeted amounts are encouraged to include in their financial statements a cross reference to such documents, particularly to link budget and actual data to non-financial budget data and service achievements.
- 2.1.40 As noted in paragraph 1.9.32 of this Standard, entities may take different approaches to determining the annual budget within the multi-period budget. Where multi-period budgets are adopted, entities are encouraged to provide additional disclosures about such matters as the relationship between the multi period budget and component annual budgets and actual amounts during the budget period.

Consolidated Financial Statements

- 2.1.41 *An entity is encouraged to disclose in the notes to the financial statements:*
 - (a) *The proportion of ownership interest in controlled entities and, where that interest is in the form of shares, the proportion of voting power held (only where this is different from the proportionate ownership interest);*
 - (b) *Where applicable:*
 - (i) *The name of any controlled entity in which the controlling entity holds an ownership interest and/or voting rights of 50% or less, together with an explanation of how control exists; and*
 - (ii) *The name of any entity in which an ownership interest of more than 50% is held but which is not a controlled entity, together with an explanation of why control does not exist; and*
 - (c) *In the controlling entity's separate financial statements, a description of the method used to account for controlled entities.*

- 2.1.42 *A controlling entity which does not present a consolidated statement of cash receipts and payments is encouraged to disclose the reasons why the consolidated financial statements have not been presented together with the bases on which controlled entities are accounted for in its separate financial statements. It is also encouraged to disclose the name and the principal address of its controlling entity that publishes consolidated financial statements.*
- 2.1.43 Paragraph 1.6.20(b) of Part 1 of this Standard requires that the reasons for non-consolidation of a controlled entity should be disclosed. Paragraphs 1.6.7 and 1.6.8 of Part 1 of the Standard also provide that a controlling entity that is itself a wholly owned entity or a controlling entity that is virtually wholly owned, need not present a consolidated financial statement. When this occurs, the disclosure of the information in paragraph 2.1.42 above is encouraged.

Acquisitions and Disposals of Controlled Entities and Other Operating Units

- 2.1.44 *An entity is encouraged to disclose and present separately the aggregate cash flows arising from acquisitions and from disposals of controlled entities or other operating units.*
- 2.1.45 *An entity is encouraged to disclose in the notes to the financial statements, in aggregate in respect of both acquisitions and disposals of controlled entities or other operating units during the period, each of the following:*
- (a) *The total purchase or disposal consideration (including cash or other assets);*
 - (b) *The portion of the purchase or disposal consideration discharged by means of cash; and*
 - (c) *The amount of cash in the controlled entity or operating unit acquired or disposed of.*
- 2.1.46 The separate presentation of the cash flow effects of acquisitions and disposals of controlled entities and other operations, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from cash receipts and payments arising from the other activities of the entity. To enable users to identify the effects of both acquisitions and disposals, the cash flow effects of disposals would not be deducted from those acquisitions.
- 2.1.47 The aggregate amount of the cash paid or received as purchase or sale consideration is reported in the statement of cash receipts and payments net of cash acquired or disposed of.
- 2.1.48 Paragraph 2.1.33 encourages the disclosure of assets and liabilities of the entity. Assets and liabilities other than cash of a controlled entity or operating unit acquired or disposed of may also be separately disclosed, summarized by each major category. Consistent with the requirement of

paragraph 1.3.37 of Part 1 of this Standard, where such disclosure is made, the assets and liabilities should be clearly identified and the basis on which they are recognized and measured explained.

Joint Ventures

2.1.49 *An entity is encouraged to make disclosures about joint ventures which are necessary for a fair presentation of the cash receipts and payments of the entity during the period and the balances of cash as at reporting date.*

2.1.50 Many public sector entities establish joint ventures to undertake a variety of activities. The nature of these activities range from commercial undertakings to provision of community services at no charge. The terms of a joint venture are set out in a contract or other binding arrangement and usually specify the initial contribution from each joint venturer and the share of revenues or other benefits (if any) and expenses of each of the joint venturers. Entities which report on a cash basis will generally report:

- (a) As cash payments, the cash expended in the acquisition of an interest in a joint venture and in the ongoing operations of the joint venture; and
- (b) As cash receipts, the cash received from the joint venture.

Disclosures about joint ventures may include a listing and description of interests in significant joint ventures. International Public Sector Accounting Standard IPSAS 8, “Financial Reporting of Interests in Joint Ventures” in the accrual based series of IPSASs provides guidance on the different forms and structures that joint ventures may take and potential additional disclosures that might be made.

Financial Reporting in Hyperinflationary Economies

2.1.51 In a hyperinflationary economy, the presentation of the financial statements in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

2.1.52 This Standard does not identify an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgment when restatement of financial statements in accordance with the encouragements in this Standard would become necessary. Hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following:

- (a) The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;

- (b) The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;
- (c) Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;
- (d) Interest rates, wages and prices are linked to a price index; and
- (e) The cumulative inflation rate over three years is approaching, or exceeds, 100%.

The Restatement of Financial Statements

2.1.53 *An entity that reports in the currency of a hyperinflationary economy is encouraged to:*

- (a) *Restate its statement of cash receipts and payments and other financial statements in terms of the measuring unit current at the reporting date;*
- (b) *Restate the comparative information for the previous period, and any information in respect of earlier periods in terms of the measuring unit current at the reporting date; and*
- (c) *Use a general price index that reflects changes in general purchasing power. It is preferable that all entities that report in the currency of the same economy use the same index.*

2.1.54 *The entity is encouraged to make the following disclosures:*

- (a) *The fact that the statement of cash receipts and payments and other financial statements, and the corresponding figures for previous periods, have been restated for the changes in the general purchasing power of the reporting currency and, as a result, are stated in terms of the measuring unit current at the reporting date; and*
- (b) *The identity and level of the price index at the reporting date and the movement in the index during the current and the previous reporting period.*

2.1.55 Prices change over time as the result of various political, economic and social forces. Specific forces such as changes in supply and demand, and technological changes may cause individual prices to increase or decrease significantly and independently of each other. In addition, general economic forces may result in changes in the general level of prices and therefore in the general purchasing power of money.

2.1.56 In a hyperinflationary economy, the usefulness of financial statements is substantially increased if they are expressed in terms of the measuring unit current at the reporting date. As a result, the treatments and disclosures in

paragraphs 2.1.53 and 2.1.54 above are encouraged. Presentation of this information as the primary presentation rather than as a supplement to financial statements which have not been restated is encouraged. Separate presentation of the statement of cash receipts and payments and other financial statements before restatement is discouraged.

- 2.1.57 All items in the statement of cash receipts and payments will be expressed in terms of the measuring unit current at the reporting date. Therefore, all amounts, including any payments by third parties disclosed on the face of the statement of cash receipts and payments or in other financial statements, would be restated by applying the change in the general price index from the dates when the payments and receipts were initially recorded.
- 2.1.58 Many entities in the public sector include in their financial statements the related budgetary information, to facilitate comparisons with the budget. Where this occurs, this Standard encourages restatement of the budgetary information in accordance with this Standard.

Comparative Information

- 2.1.59 If comparisons with previous periods are to be meaningful, comparative information for the previous reporting period will be restated by applying a general price index so that the comparative financial statements are presented in terms of the measurement unit current at the end of the reporting period. Information that is disclosed in respect of earlier periods is also expressed in terms of the measurement unit current at the end of the reporting period.

Consolidated Financial Statements

- 2.1.60 A controlling entity that reports in the currency of a hyperinflationary economy may have controlled entities that also report in the currencies of hyperinflationary economies. If the statement of cash receipts and payments and other financial statements are to be prepared on a consistent basis, the financial statements of any such controlled entity will be restated by applying a general price index of the country in whose currency it reports before they are included in the consolidated financial statements issued by its controlling entity. Where such a controlled entity is a foreign controlled entity, its restated financial statements are translated at closing rates.
- 2.1.61 If financial statements with different reporting dates are consolidated, all items, whether non-monetary or monetary, need to be restated into the measuring unit current at the date of the consolidated financial statement.

Selection and Use of the General Price Index

- 2.1.62 The restatement of financial statements in accordance with the approach encouraged by this Standard requires the use of a general price index that

reflects changes in general purchasing power. It is preferable that all entities that report in the currency of the same economy use the same index.

- 2.1.63 The disclosures encouraged by this Standard are intended to make clear the basis of dealing with the effects of hyperinflation in the financial statements. They are also intended to provide other information necessary to understand that basis and the resulting amounts.

Assistance Received From Non-Governmental Organizations (NGOs)

- 2.1.64 *Where practicable, an entity is encouraged to apply to assistance received from non-governmental organizations (NGOs), the required disclosures identified in paragraphs 1.10.1 to 1.10.27 of Part 1 of this Standard and the encouraged disclosures identified in paragraphs 2.1.66 to 2.1.93 below.*
- 2.1.65 Reporting entities are not required to make the disclosures identified in paragraphs 1.10.1 to 1.10.27 in respect of assistance received from non-governmental organizations (NGOs). This is because the costs of collecting and aggregating the information necessary to comply with those requirements may be greater than its benefits. However, making the disclosures about assistance received from NGOs which are identified in paragraphs 1.10.1 to 1.10.27, together with the disclosures encouraged in paragraphs 2.1.66 to 2.1.93 below, can provide additional input to assessments of the extent to which the reporting entity is dependent on assistance from these organizations to support its activities. Accordingly, reporting entities are encouraged to apply the disclosures identified in this Standard to assistance received from NGOs, where it is practicable to do so.

Recipients of External Assistance

- 2.1.66 *An entity is encouraged to disclose by significant class in notes to the financial statements:*
- (a) *The purposes for which external assistance was received during the reporting period, showing separately amounts provided by way of loans and grants; and*
 - (b) *The purposes for which external assistance payments were made during the reporting period.*
- 2.1.67 An entity may receive external assistance for many purposes including assistance to support its:
- (a) Economic development or welfare objectives, often termed development assistance;
 - (b) Emergency relief objectives, often termed emergency assistance;

- (c) Balance of payments position or to defend its currency exchange rate, often termed balance of payments assistance;
 - (d) Military and/or defense objectives, often termed military assistance; and
 - (e) Trading activities, including export credits or loans offered by export/import banks or other government agencies, often termed trade finance.
- 2.1.68 Part 1 of this Standard requires disclosure of the total amount of external assistance received during the reporting period showing separately the total amount received by way of grants and loans. Disclosure of the significant classes of external assistance received by way of loan or grant will enable users to determine the purposes for which assistance was provided during the period, the amounts thereof and whether the entity has an obligation to repay the assistance provided at some time in the future.
- 2.1.69 Disclosure by significant class of the purposes for which external assistance payments were made during the reporting period will further enhance the entity's accountability for its use of external assistance received.
- 2.1.70 *An entity is encouraged to identify in notes to the financial statements each provider of external assistance during the reporting period and the amount provided, excluding any undrawn amounts, showing separately amounts provided by way of loans and grants in the currency provided.*
- 2.1.71 Disclosure of each provider of external assistance and the amount provided by way of loan and grant will indicate the extent of diversification of sources of assistance. This will assist readers of the financial statements to determine, for example, whether the entity is dependent on particular agencies for assistance, the extent of that dependency and the currency in which it was provided, and whether the assistance is provided by way of a grant or a loan which will need to be repaid in the future. The disclosure encouraged by this paragraph excludes amounts that have not been drawn down during the period. Paragraph 2.1.72 encourages disclosure of information about undrawn amounts of external assistance in certain circumstances.
- 2.1.72 *In respect of external assistance that is undrawn at reporting date and is disclosed in accordance with paragraph 1.10.18 of Part 1 of this Standard, an entity is encouraged to disclose in notes to the financial statements:*
- (a) *Each provider of loan assistance and grant assistance and the amount provided by each;*
 - (b) *The purposes for which the undrawn loan assistance and undrawn grant assistance may be used;*
 - (c) *The currency in which the undrawn assistance is held or will be made available; and*

- (d) *Changes in the amount of undrawn loan assistance and undrawn grant assistance during the period.*

- 2.1.73 Undrawn external assistance balances are required to be disclosed in certain circumstances by paragraph 1.10.18 of Part 1 of this Standard. The disclosures encouraged by paragraph 2.1.72 will enable readers of the financial statements to determine the purposes for which such undrawn assistance may be used in the future, the currency in which that undrawn assistance is held or will be made available, and whether the amount of undrawn loan and grant assistance declined or increased during the period.
- 2.1.74 As is appropriate for the reporting entity, the disclosures could usefully identify such matters as the opening balance of undrawn loans and grants, the amount of new loans and new grants approved or otherwise made available during the period, the total amount of loans and grants drawn or utilized during the period, the total amounts of loans and grants cancelled or expired during the period, and the closing balance of undrawn loans and grants. Such disclosures will assist users in identifying not only the amount of the change in undrawn balances, but also the components of that change.
- 2.1.75 Where disclosures of changes in the amount of undrawn assistance are made in the entity's reporting currency, external assistance denominated in a foreign currency will be reported in the entity's reporting currency by applying to the foreign currency amount the exchange rate on the date of each applicable transaction, consistent with the requirements of Part 1 of this Standard.
- 2.1.76 *An entity is encouraged to disclose in notes to the financial statements the terms and conditions of external assistance agreements that determine or affect access to, or limit the use of, external assistance.*
- 2.1.77 Some external assistance agreements limit or specifically define the use or purpose for which the external assistance may be used, or limit the sources from which goods or services may be purchased. This type of external assistance term or condition may specify that the funds are available only to purchase specific inputs for the construction of specified facilities at a specified location, or that the goods or services purchased under the external assistance agreement must originate from a specified country or countries.
- 2.1.78 Some external assistance may be released on specific dates, or may be released upon the entity:
- (a) Undertaking actions specified in an external assistance agreement, such as implementing specific policy changes; or
 - (b) Achieving ongoing performance targets, such as budget deficit targets or other broad economic objectives, or establishing a financial sector asset recovery or management agency.

- 2.1.79 Disclosure of terms and conditions that determine or affect access to external assistance will indicate the extent to which external assistance is time bound and/or is dependent upon the entity taking certain actions and achieving certain performance objectives, and what those actions and performance objectives are.
- 2.1.80 *An entity is encouraged to disclose in notes to the financial statements:*
- (a) *The outstanding balance of any external assistance loans for which principal and/or interest payments have been guaranteed by third parties, any terms and conditions related to those loans, and any additional terms and conditions arising from the guarantee; and*
 - (b) *The amount and terms and conditions of external assistance loans and grants for which performance of related terms and conditions have been guaranteed by third parties, and any additional terms and conditions arising from the guarantee.*
- 2.1.81 The balance of external assistance loans borrowed by an entity and payment of interest thereon may be guaranteed, in total or up to a specified amount. Terms and conditions associated with the loans may also require the recipient to take certain actions, or achieve agreed outcomes such as setting tariffs according to an agreed formula, the performance of which are guaranteed by third parties. External assistance grants may also be subject to similar terms and conditions, the performance of which are guaranteed by third parties.
- 2.1.82 Disclosure of the amounts of external assistance loans and grants guaranteed by third parties will indicate the extent of support from another entity to obtain the benefits of the external assistance agreement. Disclosure of the terms and conditions of external assistance loans and grants that have been guaranteed, and any additional terms and conditions imposed to effect that guarantee, will indicate the additional performance requirements or conditions that arise as a consequence of securing the guarantee.
- 2.1.83 *An entity is encouraged to disclose in notes to the financial statements other significant terms and conditions associated with external assistance loans, grants or guarantees that have not been complied with, together with the consequence of the non compliance.*
- 2.1.84 Paragraph 1.10.25 of Part 1 of this Standard requires the disclosure of significant terms and conditions that have not been complied with when non compliance has resulted in cancellation of the assistance or given rise to an obligation to return assistance previously provided. External assistance agreements may also include other significant terms and conditions that are to be complied with, as well as some procedural terms and conditions. Consequences of non compliance with these other significant terms and conditions may include a reduction in the amount, or variation in the timing, of funds that may be drawn or made available in the future until the default is

corrected. They may also include an increase in the interest rate charged on loan funds.

- 2.1.85 Identifying these other significant terms and conditions which have not been complied with is likely to require professional judgment. That judgment will be exercised in the context of the entity's particular circumstances and by reference to the qualitative characteristics of financial statements. These terms and conditions are likely to be those where non compliance is likely to affect the amount or timing of funds that will be available to support the entity's future operations.
- 2.1.86 *An entity is encouraged to disclose in the notes to the financial statements, a summary of the repayment terms and conditions of outstanding external assistance debt. Where disclosures of future debt service payments denominated in a foreign currency are made, the entity is encouraged to report them in the entity's reporting currency by applying to the foreign currency amount of those payments the closing rate.*
- 2.1.87 External assistance debt agreements will include terms and conditions relating to such matters as the grace period, interest rate, current debt service payments, future debt service payments, remaining term of the loan, currency of debt service payments, principal repayment requirements (where repayment of the principal is deferred until the end of the loan term, or some other future date), and other significant repayment terms.
- 2.1.88 Debt service payments may be a significant cash outlay for the entity and will impact on cash available to fund current and additional operations. Disclosure of repayment terms and conditions of outstanding external assistance debt will enable readers of the financial statements to determine when debt service payments (principal and interest or service charges) will commence, and the amount of principal and interest or service charge payable.
- 2.1.89 Disclosure of information about repayment terms and conditions may require the estimation of, for example, the interest rate to be applied to variable rate debt. The estimated interest rate will usually be determined by reference to applicable interest rates at the closing date. In accordance with the requirements of paragraphs 1.3.30 to 1.3.37 of Part 1 of this Standard, when an entity elects to make disclosures which involve estimates, the accounting policies selected and applied in developing such estimates will be disclosed where necessary for a proper understanding of the financial statements.
- 2.1.90 *An entity is encouraged to disclose separately in the notes to the financial statements the value of external assistance received in the form of goods or services.*
- 2.1.91 Significant resources may be received under external assistance agreements in the form of goods or services. This will occur when new or used goods such as vehicles, computers or other equipment are transferred to the entity

under an external assistance agreement. It will also occur when food aid is provided to a government for distribution to its citizens under an external assistance agreement. For some recipients, goods or services may be the major form in which external assistance is received.

- 2.1.92 Disclosure of the value of external assistance received as goods and services will assist readers of the financial statements to better understand the full extent of external assistance received during the reporting period. However, in some cases and for some recipients, determining the value of such goods and services can be a difficult, time consuming and costly process. This is particularly so where a domestic market price for those goods and services cannot be readily determined, where the goods and services provided are not widely traded in international markets or where they are of an unique nature, such as often occurs in respect of emergency assistance.
- 2.1.93 This Standard does not specify the basis on which the value of the goods or services is to be determined. Therefore, their value may be determined as the depreciated historical cost of physical assets at the time the assets are transferred to the recipient or the price paid for the food by the external assistance agency. It may also be determined on the basis of an assessment of the value by management of the transferor, or the recipient, or by a third party. Where the value of external assistance in the form of goods or services is disclosed, paragraph 1.10.21 of Part 1 of this Standard requires the disclosure of the basis on which that value is determined. Where such is described as fair value it will conform with the definition of fair value—that is, the amount for which an asset could be exchanged, or a liability settled, between knowledgeable and willing parties in an arm's length transaction.

2.2 Governments and Other Public Sector Entities Intending to Migrate to the Accrual Basis of Accounting

Presentation of the Statement of Cash Receipts and Payments

- 2.2.1 *An entity which intends to migrate to the accrual basis of accounting is encouraged to present a statement of cash receipts and payments in the same format as that required by International Public Sector Accounting Standard (IPSAS 2), "Cash Flow Statements."*
- 2.2.2 IPSAS 2 provides guidance on classifying cash flows as operating, financing and investing and includes requirements for preparing a statement of cash flows which reports these classes separately on the face of the statement. A summary of key aspects of IPSAS 2 and guidance on their application for financial reporting under this Standard is included in Appendix 3. Part 2 of this Standard encourages disclosure of information additional to that required by IPSAS 2. Entities which adopt the format of IPSAS 2 for the presentation of the statement of cash receipts and payments are encouraged to also make the additional disclosures identified in Part 2 of this Standard.

Scope of Consolidated Statements—Exclusions from the Economic Entity

- 2.2.3 When an entity adopts the accrual basis of accounting in accordance with the accrual IPSASs, it will not consolidate entities in which control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its subsequent disposal in the near future. Temporary control may occur where, for example, a national government intends to transfer its interest in a controlled entity to a local government.
- 2.2.4 Part 1 of this Standard does not provide for such entities to be excluded from the consolidated financial statements prepared under the cash basis. This is because:
- (a) The cash of an entity which is controlled on only a temporary basis can be used for the benefit of the economic entity during the period of temporary control; and
 - (b) The potentially complex consolidation adjustments that may be necessary under the accrual basis will not arise under the cash basis.
- 2.2.5 For this exemption from consolidation to apply under the accrual IPSASs, the controlling entity must be demonstrably committed to a formal plan to dispose of, or no longer control, the entity that is subject to temporary control. For the exemption to apply at more than one successive reporting date, the controlling entity must demonstrate an ongoing intent to dispose of, or no longer control, the entity that is subject to temporary control. An entity is demonstrably committed to dispose of, or no longer control, another entity when it has a formal plan to do so and there is no realistic possibility of withdrawal from that plan.
- 2.2.6 Entities preparing to migrate to the accrual basis will need to be aware of this difference in consolidation requirements of the accrual and cash basis IPSASs, and to determine whether, for any controlled entities included in the consolidated statement of receipts and payments, control is temporary.

Appendix 2

Illustration of Certain Disclosures Encouraged in Part 2 of the Standard

This appendix is illustrative only. The purpose of the appendix is to illustrate the application of the encouragements and to assist in clarifying their meaning.

Extract from notes to financial statements of Entity ABC

Administered Transactions (paragraph 2.1.15)

Administered transactions comprise cash flows resulting from transactions administered by the Entity as an agent on behalf of the government and specific government bodies. All cash collected in the capacity of an agent is deposited in the consolidated revenue fund and/or trust account (name of account), as appropriate. These accounts are not controlled by the Entity and the cash deposited in them cannot be used by the Entity without specific authorization by the relevant government body.

(in thousands of currency units)	Nature of Transaction	200X	200X-1
Cash collected on behalf of			
The Executive/Crown	Collection of taxation	X	X
Agency EF	Collection of utility service fee	<u>X</u>	<u>X</u>
		X	X
Cash transferred to respective entities		(X)	(X)
		—	—

Related Party Transactions (paragraph 2.1.31)

The key management personnel (as defined by IPSAS 20, “Related Party Disclosures”) of Entity ABC are the Minister, the members of the governing body and the members of the senior management group. The governing body consists of members appointed by Government A. The chief executive officer and the chief financial officer attend meetings of the governing body but are not members of the governing body. The Minister is not remunerated by Entity ABC. The aggregate remuneration of members of the governing body and the number of members determined on a full time equivalent basis receiving remuneration within this category, are:

Aggregate remuneration AX million.
 Number of persons AY persons.

The senior management group consists of the Entity's chief executive officer, the chief financial officer, and the heads of division. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category are:

Aggregate remuneration AP million.
 Number of persons AQ persons.

Extract from notes to financial statements of Government X

Assets and Liabilities (paragraph 2.1.33(a))

Property, plant and equipment

The Government commenced the process of identifying and valuing major classes of its property, plant and equipment. The assets are stated at historical cost or valuation. The valuations were performed by an independent professional valuer. The valuation bases used for each class of assets are as follows:

Plant and Equipment Cost
 Land Current Value
 Buildings Cost or Market Value

(in thousands of currency units)	200X	200X-1
Plant and equipment	X	X
Land and buildings		
Property within city limits	X	X
Buildings at cost	X	X
Buildings at valuation	X	X
	X	X

*(Extract from notes to financial statements of Government X: Assets and Liabilities
(paragraph 2.1.33(a) continued)*

Borrowings

The borrowings of the Government are listed below:

	200X	200X-1
(in thousands of currency units)		
Balance at beginning of year	X	X
PROCEEDS		
Domestic Commercial Institution	X	X
Offshore Commercial Institution	X	X
Development Banks and Similar Lending Agencies	X	X
Total borrowings	X	X
REPAYMENTS		
Domestic Commercial Institution	(X)	(X)
Offshore Commercial Institution	(X)	(X)
Development Banks and Similar Lending Agencies	(X)	(X)
Total repayments	(X)	(X)
Balance at end of year	X	X

(Extract from notes to financial statements of Government X continued)

Comparison with budget when the entity does not make its budget publicly available (paragraph 2.1.33 (b))

(in thousands of currency units)	Actual	Budgeted	Variance
RECEIPTS			
<i>Taxation</i>			
Income tax	X	X	X
Value-added tax	X	X	(X)
Property tax	X	X	X
Other taxes	<u>X</u>	<u>X</u>	<u>(X)</u>
	X	X	X
<i>Aid Agreements</i>			
International agencies	X	X	–
Other Grants and Aid	<u>X</u>	<u>X</u>	=
	X	X	–
<i>Borrowings</i>			
Proceeds from borrowings	X	X	(X)
<i>Capital Receipts</i>			
Proceeds from disposal of plant and equipment	X	X	X
<i>Trading Activities</i>			
Receipts from trading activities	X	X	X
<i>Other receipts</i>	X	X	X
Total receipts	<u>X</u>	<u>X</u>	<u>X</u>
PAYMENTS			
<i>Operations</i>			
Wages, salaries and employee benefits	(X)	(X)	(X)
Supplies and consumables	<u>(X)</u>	<u>(X)</u>	<u>X</u>
	(X)	(X)	(X)
<i>Transfers</i>			
Grants	(X)	(X)	–
Other transfers	<u>(X)</u>	<u>(X)</u>	=
	(X)	(X)	–
<i>Capital Expenditures</i>			
Purchase/construction of plant and equipment	(X)	(X)	(X)
Purchase of financial instruments	<u>(X)</u>	<u>(X)</u>	=
	(X)	(X)	(X)
<i>Loan and Interest Repayments</i>			
Repayment of borrowings	(X)	(X)	–
Interest payments	<u>(X)</u>	<u>(X)</u>	=
	(X)	(X)	–
<i>Other payments</i>	(X)	(X)	X
Total payments	<u>(X)</u>	<u>(X)</u>	<u>(X)</u>
NET RECEIPTS/(PAYMENTS)	<u>X</u>	<u>X</u>	<u>X</u>

Extract from notes to financial statements of Entity XYZ***Controlled Entities (paragraphs 2.1.41, 2.1.44, and 2.1.45)***

Entity XYZ has the power to govern the financial and operating policies so as to benefit from the activities of other entities. These are controlled entities. All controlled entities are included in the consolidated financial statements. (Paragraph 1.6.20(a) in Part 1 of this Standard requires that a list of significant controlled entities be disclosed.)

Control of government entities arises by way of statute or other enabling legislation. Control of government business enterprises arises by way of statute and in the case of Enterprise C and D, by way of ownership interest. Entity XYZ retains control of Enterprise E through legislative authority although the majority of the equity of Enterprise E has been sold to private investors.

Enterprise	Ownership Interest (%)	Voting Power (%)
Enterprise E	XX	XX

Acquisitions of Controlled Entities and Operating Units

Names of Enterprises acquired	Proportion of shares acquired %	Purchase consideration (in thousands of currency units)	Cash portion of purchase consideration (in thousands of currency units)	Cash balances acquired (in thousands of currency units)
Enterprise C	XX	X	X	X
Enterprise D	XX	X	X	X
		X	X	X

(Extract from notes to financial statements of Entity XYZ continued)

Disposals of Controlled Entities and Other Operating Units

Name of Enterprise disposed of	Proportion of shares disposed of %	Disposal consideration (in thousands of currency units)	Cash portion of disposal consideration (in thousands of currency units)	Cash balance disposed of (in thousands of currency units)
Enterprise F	XX	X	X	X

Significant Joint Ventures (paragraph 2.1.49)

Name of Joint Venture	Principal Activity	Output Interest	
		200X %	200X-1 %
Regional Water Board	Water provision	XX	XX
Regional Electricity Board	Provision of utility services	XX	XX

Extract from notes to financial statements of Government B:***Biennial Budget on Cash Basis—For the Year Ended December 31, 200X (paragraph 2.1.38)***

(in thousands of currency units)	Original Biennial Budget Year	Target Budget for 1 st Year	Revised Budget in 1 st Year	1 st Year Actual on Comparable Basis	Balance Availabl e for 2 nd Year	Target Budget for 2 nd Year	Revised Budget in 2 nd Year	2 nd Year Actual on Comparable Basis	<i>*Difference: Budget and Actual for Budget Period</i>
CASH INFLOWS									
Taxation	X	X	X	X	X	X	X	X	X
Aid agreements	X	X	X	X	X	X	X	X	X
Proceeds: borrowing	X	X	X	X	X	X	X	X	X
Proceeds: disposal of plant and equipment	X	X	X	X	X	X	X	X	X
Other receipts	X	X	X	X	X	X	X	X	X
Total inflows	X	X	X	X	X	X	X	X	X
CASH OUTFLOWS									
Health	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Public order and safety	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)

* This column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

ENCOURAGED ADDITIONAL DISCLOSURES

(in thousands of currency units)	Original Biennial Budget Year	Target Budget for 1 st Year	Revised Budget in 1 st Year	1 st Year Actual on Comparable Basis	Balance Availabl e for 2 nd Year	Target Budget for 2 nd Year	Revised Budget in 2 nd Year	2 nd Year Actual on Comparable Basis	<i>*Difference: Budget and Actual for Budget Period</i>
Social protection	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Defense	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Housing, community amenities	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Recreational, cultural, religion	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Total outflows	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
NET CASH FLOW	X	X	X	X	X	X	X	X	X

Extract From Notes to the Financial Statements of Government C**Assistance Provided by Non-Governmental Organizations (NGOs)** (*Paragraph 2.1.64*)

Assistance from NGOs is included in the amount of “Other Grants and Aid” in the Statement of Cash Receipts and Payments. The amount of assistance from NGOs received during the reporting period in the reporting currency is:

	200X		200X–1	
	Cash Receipts	Payments by third parties	Cash Receipts	Payments by third parties
Grant Funds	X	X	X	–
Loan Funds	–	–	–	–
Total	X	X	X	–

Assistance was received from NGOs under agreements specifying that the assistance would be utilized for the following purposes:

	Development Assistance		Emergency Assistance		Other		Total	
	<u>200X</u>	<u>200X–1</u>	<u>200X</u>	<u>200X–1</u>	<u>200X</u>	<u>200X–1</u>	<u>200X</u>	<u>200X–1</u>
NGO 1	X	X	–	–	–	X	X	X
NGO 2	–	–	X	–	–	–	X	–
NGO 3	X	X	X	–	–	–	X	X
Total	X	X	X	–	–	X	X	X
USD	X	X	X	X	–	X	X	X
Euro	X	X	X	–	–	–	X	X
Yen	–	–	X	X	–	–	X	X

The currency in which external assistance was provided was as follows:

- NGO 1 – US Dollars to the amount of YYY and other currency being (specify currency) to the amount of X
- NGO 2 – Euros to the amount of YYY
- NGO 3 – Yen to the amount of YYY

The assistance was fully used for the purposes specified.

While NGO 1, 2 and 3 have indicated their intention to provide ongoing emergency assistance as the need arises and their resources allow, the extent of the assistance is not

subject to binding written agreements. It will be determined on the basis of an assessment of needs and the capacity of each NGO to provide ongoing assistance.

During 200X, NGO 1 provided medical teams and medical equipment in support of earthquake victims in the ZZZ region. Temporary shelter, food and clothing were also supplied by NGO 2. The value of the goods and services received has been estimated at XX domestic currency units. The value of the specialized emergency assistance provided has been determined based on cost estimates provided by the NGOs involved.

There have been no instances of non compliance with terms and conditions which have resulted in cancellation of assistance grants.

There were no amounts of undrawn assistance from NGOs in 200X or 200X-1.

ENCOURAGED ADDITIONAL DISCLOSURES

Extract From Notes to the Financial Statements of Government C

Classes of External Assistance (*Paragraph 2.1.66 and 2.1.70*)

During the reporting period external assistance was received from multilateral and bilateral external assistance agencies under agreements specifying that the assistance would be utilized for the following purposes:

	Development Assistance		Emergency Assistance		Other		Total	
	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>
Loan Funds	X	X	–	–	X	–	X	X
Grant Funds	X	–	X	X	–	–	X	X
Total	X	X	X	X	X	–	X	X
Amount utilized	X	X	X	X	X	–	X	X

	Agency 1		Agency 2		Agency 3		Agency 4	
	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>
Loan Funds	X	X	–	–	X	–	X	X
Grant Funds	X	–	X	X	–	X	X	X
Total	X	X	X	X	X	X	X	X
Currency: US Dollar	X	X	–	–	–	–	–	–
Euro	–	–	X	X	–	–	–	–
Yen	–	–	–	–	X	X	–	–
Other	–	–	–	–	–	–	X	X

ENCOURAGED ADDITIONAL DISCLOSURES

Undrawn External Assistance (*Paragraph 2.1.72*)

Undrawn external assistance loans and grants consist of amounts which have been specified in a binding agreement with external assistance agencies but have not been utilized at reporting date, and are subject to terms and conditions that have been satisfied in the past and it is anticipated will be satisfied in the future. External assistance loans cancelled or expired resulted from overestimation of the cost of development projects. Changes in the amount of undrawn assistance loans and grants are presented in the entity's reporting currency.

	Development Assistance		Emergency Assistance		Other		Total	
	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>
<i>Opening balance</i>								
Loans	X	X	–	–	X	X	X	X
Grants	X	X	–	X	–	–	X	X
<i>Approved in period</i>								
Loans	X	X	–	–	X	–	X	X
Grants	X	X	X	X	X	X	X	X
<i>Total available</i>	X	X	X	X	X	X	X	X
Loans drawn down	(X)	(X)	–		(X)	(X)	(X)	–
Grants drawn down	(X)	(X)	(X)	(X)	–	–	(X)	(X)
Loans cancelled/expired	(X)	(X)	–	–	–	–	(X)	(X)
Grants cancelled/expired	–	–	–	–	–	–	–	–
Exchange difference	X	X	–	–	X	X	X	X
<i>Closing balance – Loans</i>	X	X	–	–	X	X	X	X
<i>Closing balance – Grants</i>	X	X	–	–	X	X	X	X

ENCOURAGED ADDITIONAL DISCLOSURES

Closing balance	Development Assistance		Emergency Assistance		Other		Total	
By currency held	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>	<u>200X</u>	<u>200X-1</u>
US Dollar	X	X	–	X	X	X	X	X
Euro	X	X	–	X	X	X	X	X
Yen	X	X	–	–	X	X	X	X
Other	X	X	–	–	–	–	X	–
By reporting currency								
<i>Loans</i>								
Agency 1	X	X	–	–	X	X	X	X
Agency 4	X	X	–	–	X	X	X	X
<i>Grants</i>								
Agency 2	X	X	–	X	X	X	X	X
Agency 4	X	X	–	X	X	X	X	X
Total	X	X	–	X	X	X	X	X

Significant terms and conditions (*Paragraph 2.1.76*)*General Restrictions*

The balance of commitments for, and undrawn balances of, external assistance is subject to, or restricted by, performance of agreed actions or the maintenance of agreed economic or financial performance levels.

The Government has prepared an economic development plan for receipt of development assistance. The plan includes a poverty reduction strategy which is supported by the donor community. The Government and the donors have agreed the following major targets within the poverty reduction strategy: (Entity to identify major targets).

The Government and the donor community have agreed on methods to monitor progress to achieve the agreed targets and will meet annually to review progress.

Loans and grants to support specific projects include financial performance targets for all electricity and water utilities to ensure adequate revenue to cover the cost of providing services, to properly maintain existing utility assets and to contribute to a program of asset replacement and renewal.

Procurement Restrictions

Certain development assistance received is subject to restrictions in regards to the nature of goods or services that may be purchased or the country in which the goods or services may be purchased. All multilateral development bank loans or grants are restricted in that (a) they prohibit the use of their funds for the purchase of military goods or services, luxury goods or environmentally damaging goods; and (b) the purchase of goods or services must be from their respective member countries. External assistance from bilateral agencies is either unrestricted or limited to purchases of goods or services from the country providing the funds. All “Specific Purpose Loans or Grants” fund specifically defined projects and, as such, the procurement of goods and services is restricted to the agreed inputs for each project.

Non Compliance with other significant terms and conditions (*Paragraph 2.1.83*)

The Government’s expenditures in the education sector did not meet the target level primarily due to construction delays caused by an earthquake. Expenditures were X percent below the target. Steps have been taken to correct the under investment in the education sector and the Government and the relevant donors support the corrective actions planned. The Government has complied with all procurement regulations applicable under all outstanding external assistance loans and grants.

Guarantees of external assistance loans and grants (*Paragraph 2.1.80*)

The Government of YYYY has guaranteed an outstanding export financing loan in the amount of currency units XXX (200X–1: Nil). The principal is to be repaid in 5 years. The interest rate applicable to the outstanding balance is Y percent. Annual, interest only service payments are to be made. No additional terms or conditions

arise from the guarantee. No other external assistance loans or grants are subject to guarantees by third parties.

Repayment Terms and Conditions—Debt Service Obligations (*Paragraph 2.1.86*)

The terms of development assistance loans include grace periods which range from 0 to a maximum of 7 years. Interest rates include both fixed rates and variable rates. All development assistance loans are denominated in US Dollars or Euros. Interest rates on fixed rate loans as at fiscal year ending 200X, range from X percent to Y percent with a weighted average of Z percent. For the fiscal year ending 200X–1, they range from X percent to Y percent with a weighted average of Z percent. Interest rates on variable rate loans range from LIBOR plus X percent to LIBOR plus Y percent with a weighted average at the end of fiscal year 200X of Z percent and at the end of fiscal year 200X–1 of Z percent.

Other external assistance loans do not include a grace period, and are denominated in a range of currencies including US Dollars, Euros and Yen.

<u>200X</u>				
Outstanding Debt by Remaining Grace Period Years				
	Expired	0–4	5–7	Total
Development Assistance	X	X	X	X
Other	X	–	–	X
Total	X	X	X	X

<u>200X–1</u>				
Outstanding Debt by Remaining Grace Period Years				
	Expired	0–4	5–7	Total
Development Assistance	X	X	X	X
Other	X	–	–	X
Total	X	X	X	X

Development assistance loans have repayment periods varying from X years to Y years subsequent to the grace period with a weighted average for outstanding debt of Z years including the grace period. In all cases, the debt service is based on a fixed payment of principal plus interest accrued.

Other external assistance loans have repayment periods varying from X to Y years with a weighted average of Z years. Debt service is based on a fixed payment of principal plus interest accrued.

200X**Debt Service Payments Including Interest**

	US				
	Dollar	Euro	Yen	Other	Total
Development Assistance	X	X	X	X	X
Other	X	X	–	–	X
Total	X	X	X	X	X

200X–1**Debt Service Payments Including Interest**

	US				
	Dollar	Euro	Yen	Other	Total
Development Assistance	X	X	X	X	X
Other	X	X	–	–	X
Total	X	X	X	X	X

All debt service payments for subsequent years are based on payment of a fixed amount comprising principal plus accrued interest. The interest payment or service charge component is based on the outstanding principal of each loan at the end of the current year, and for variable interest rate loans, at interest rates prevailing at that date. Debt service payments denominated in foreign currency have been determined by applying the closing rate of exchange on the reporting date of the financial statements.

200X + 1 and X Subsequent Years**Debt Service Payments Including Interest**

	US				
	Dollar	Euro	Yen	Other	Total
Development Assistance	X	X	X	X	X
Other	X	X	–	–	X
Total	X	X	X	X	X

Receipt of Goods and Services (*Paragraph 2.1.90 and 1.10.21*)

During 200X, a severe earthquake occurred in the ZZZ region inflicting serious damage to government property and private property, and significant loss of life. Multilateral agencies and bilateral agencies of several nations donated personnel and equipment to assist in locating and rescuing individuals trapped in the rubble. In addition, specialized medical teams trained in trauma treatment together with medical equipment, were flown into the region. Temporary shelter and food were also supplied. The value of goods and

ENCOURAGED ADDITIONAL DISCLOSURES

services received has been estimated at XX domestic currency units. The value of the emergency assistance provided has been determined based on cost estimates provided by the bilateral aid agencies involved because local prices for equivalent goods or services were not available.

Fifty thousand tons of rice was received as food aid during the year. It has been valued at XX domestic currency units which represents the wholesale price of similar rice in domestic wholesale markets.

Goods and services received during the year have not been recorded in the Statement of Cash Receipts and Payments, which reflects only cash received (directly or indirectly) or paid by the Government. Goods and services-in-kind were received as part of the emergency assistance and are reflected in this note.

Appendix 3

Presentation of the Statement of Cash Receipts and Payments in the Format Required by IPSAS 2 Statement of Cash Flows

Paragraph 2.2.1 of Part 2 of this Standard encourages an entity which intends to migrate to the accrual basis of accounting to present a statement of cash receipts and payments in the same format as that required by IPSAS 2, "Statement of Cash Flows." IPSAS 2 is applied by an entity which reports on an accrual basis of accounting in accordance with International Public Sector Accounting Standards.

This appendix provides a summary of key aspects of IPSAS 2 and guidance on their application for financial reporting under the cash basis of accounting as required by this Standard. Entities intending to present a statement of cash receipts and payments in accordance with the requirements of IPSAS 2 as far as is appropriate will need to refer to that IPSAS.

Presentation in the Format Required by IPSAS 2 Statement of Cash Flows

1. IPSAS 2 requires an entity which prepares and presents financial statements under the accrual basis of accounting to prepare a cash flow statement which reports cash flows during the period classified by operating, investing and financing activities as defined below.

Definitions

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

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

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

Components of the Financial Statements

3. In presenting a statement of cash receipts and payments in this format it may be necessary to classify cash flows arising from a single transaction in different ways. (The term cash flow statement is used in the remainder of this appendix for a statement of cash receipts and payments presented in the same format as that required by IPSAS 2.) For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element may be classified as a financing activity. An entity presenting information by way of a cash flow statement presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its activities.

4. A cash flow statement will include line items which present the following amounts:
 - (a) Total receipts from operating activities;
 - (b) Total payments on operating activities;
 - (c) Net cash flows from operating activities;
 - (d) Net cash flows from investing activities;
 - (e) Net cash flows from financing activities;
 - (f) Beginning and closing balances of cash; and
 - (g) Net increase or decrease in cash.

Additional line items, headings and sub-totals will also be presented on the face of the statement when such presentation is necessary to present fairly the entity's cash flows.

5. An entity will also present on the face of the cash flow statement or in the notes:
 - (a) Major classes of gross cash receipts and gross cash payments arising from operating, investing and financing activities, except to the extent that paragraph 1.3.13 of Part 1 of this Standard allows reporting on a net basis;
 - (b) A sub-classification of total cash receipts from operations in a manner appropriate to an entity's operations; and
 - (c) An analysis of payments on operating activities using a classification based on either the nature of payments or their function within the entity, as appropriate.

Separate disclosure of payments made for capital acquisitions and for interest and dividends is also consistent with the requirements of IPSAS 2.

6. Disclosure of information about such matters as whether cash is generated from taxes, fines, fees (operating activities), the sale of capital assets (investing activities) and/or borrowings (financing activities) and whether it was expended to meet operating costs, for the acquisition of capital assets (investing activities) or for the retirement of debt (financing activities) will enhance transparency and accountability of financial reports. These disclosures will also facilitate more informed analysis and assessments of the entity's current cash resources and the likely sources and sustainability of future cash inflows. Accordingly, this Standard encourages all entities to disclose this information in the financial statements and/or related notes.

Operating Activities

7. The amount of net cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity are funded:

- (a) By way of taxes (directly and indirectly); and
- (b) From the recipients of goods and services provided by the entity.

The disclosure of the amount of net cash flows from operating activities also assists in identifying the extent to which operations of the entity generate cash that can be deployed to repay obligations, pay a dividend/distribution to its owner and make new investments without recourse to external sources of financing. The consolidated whole-of-government operating cash flows provide an indication of the extent to which a government has financed its current activities through taxation and charges. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

8. Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. Examples of cash flows from operating activities are:
 - (a) Cash receipts from taxes, levies and fines;
 - (b) Cash receipts from charges for goods and services provided by the entity;
 - (c) Cash receipts from grants, or transfers and other appropriations or budget authorizations made by central government or other public sector entities, including those made for the acquisition of capital assets;
 - (d) Cash receipts from royalties, fees and commissions;
 - (e) Cash payments to other public sector entities to finance their operations (not including loans or equity injections);
 - (f) Cash payments to suppliers for goods and services;
 - (g) Cash payments to and on behalf of employees;
 - (h) Cash receipts and cash payments of a public sector insurance entity for premiums and claims, annuities and other policy benefits;
 - (i) Cash payments of local property taxes or income taxes (where appropriate) in relation to operating activities;
 - (j) Cash receipts and payments from contracts held for dealing or trading purposes;
 - (k) Cash receipts or payments from discontinuing operations; and
 - (l) Cash receipts or payments in relation to litigation settlements.
9. An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by

public financial institutions are usually classified as operating activities since they relate to the main cash-generating activity of that entity.

10. In some jurisdictions, governments or other public sector entities will appropriate or authorize funds to entities to finance the operations of the entity, and no clear distinction is made for the disposition of those funds between current activities, capital works and contributed capital. Where an entity is unable to separately identify appropriations or budget authorizations as current activities, capital works (operating activities) and contributed capital (investing activities), IPSAS 2 explains that the entity should classify the appropriation or budget authorization as cash flows from operations, and disclose this in the notes to the statement of cash flows.

Investing Activities

11. The separate disclosure of cash flows arising from investing activities identifies the extent to which cash outflows have been made for resources which are intended to contribute to the entity's future service delivery. Examples of cash flows arising from investing activities are:
 - (a) Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalized development costs and self-constructed property, plant and equipment;
 - (b) Cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;
 - (c) Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);
 - (d) Cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);
 - (e) Cash advances and loans made to other parties (other than advances and loans made by a public financial institution);
 - (f) Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a public financial institution);
 - (g) Cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the payments are classified as financing activities; and

- (h) Cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

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

Financing Activities

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

Interest and Dividends

13. IPSAS 2 requires the separate disclosure of cash flows from interest and dividends received and paid. IPSAS 2 also requires that where such disclosures are made they should be classified in a consistent manner from period to period as either operating, investing or financing activities.
14. The total amounts of interest and dividends paid and received during a period are disclosed in the cash flow statement. Interest paid and interest and dividends received are usually classified as operating cash flows for a public financial institution. However, there is no consensus on the classification of the cash flows associated with interest and dividends received and paid for other entities. Interest and dividends paid and interest and dividends received may be classified as operating cash flows. Alternatively, interest and dividends paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

Reporting Major Classes of Receipts and Payments

15. The sub-classification of receipts depends upon the size, nature and function of the amounts involved. Depending upon the nature of the entity, the following sub-classifications may be appropriate:

ENCOURAGED ADDITIONAL DISCLOSURES

- (a) Receipts from taxation (these may be further sub-classified into types of taxes);
 - (b) Receipts from fees, fines, penalties and licenses;
 - (c) Receipts from exchange transactions including receipts from the sale of goods and services and user charges (where these are classified as exchange transactions);
 - (d) Receipts from grants, transfers, or budget appropriations (possibly classified by source); and
 - (e) Receipts from interest and dividends.
16. Payment items are sub-classified in order to highlight the costs and cost recoveries of particular programs, activities or other relevant segments of the reporting entity. Examples of classification of payments by nature and function are included in Part 1 of this Standard.

Appendix 4

Qualitative Characteristics of Financial Reporting

Paragraph 1.3.32 of Part 1 of this Standard requires that the financial statements provide information that meets a number of qualitative characteristics. This appendix summarizes the qualitative characteristics of financial reporting.

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. They are applicable to financial statements, regardless of the basis of accounting used to prepare the financial statements. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

Understandability

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

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

Relevance

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

Materiality

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

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

Reliability

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

Faithful Representation

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

Substance over Form

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

Neutrality

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

Prudence

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

Completeness

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

Comparability

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

Comparability applies to the:

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

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

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

Constraints on Relevant and Reliable Information*Timeliness*

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

Balance between Benefit and Cost

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

Balance between Qualitative Characteristics

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

Appendix 5**Establishing Control of Another Entity for Financial Reporting Purposes**

1. Whether an entity controls another entity for financial reporting purposes is a matter of judgment based on the definition of control in this Standard and the particular circumstances of each case. That is, consideration needs to be given to the nature of the relationship between the two entities. In particular, the two elements of the definition of control in this Standard need to be considered. These are the power element (the power to govern the financial and operating policies of another entity) and the benefit element (which represents the ability of the controlling entity to benefit from the activities of the other entity).
2. For the purposes of establishing control, the controlling entity needs to benefit from the activities of the other entity. For example, an entity may benefit from the activities of another entity in terms of a distribution of its surpluses (such as a dividend) and is exposed to the risk of a potential loss. In other cases, an entity may not obtain any financial benefits from the other entity but may benefit from its ability to direct the other entity to work with it to achieve its objectives. It may also be possible for an entity to derive both financial and non-financial benefits from the activities of another entity. For example, a Government Business Enterprise (GBE) may provide a controlling entity with a dividend and also enable it to achieve some of its social policy objectives.

Control for Financial Reporting Purposes

3. For the purposes of financial reporting, control stems from an entity's power to govern the financial and operating policies of another entity and does not necessarily require an entity to hold a majority shareholding or other equity interest in the other entity. The power to control must be presently exercisable. That is, the entity must already have had this power conferred upon it by legislation or some formal agreement. The power to control is not presently exercisable if it requires changing legislation or renegotiating agreements in order to be effective. This should be distinguished from the fact that the existence of the power to control another entity is not dependent upon the probability or likelihood of that power being exercised.
4. Similarly, the existence of control does not require an entity to have responsibility for the management of (or involvement in) the day-to-day operations of the other entity. In many cases, an entity may only exercise its power to control another entity where there is a breach or revocation of an agreement between a controlled entity and its controlling entity.
5. For example, a government department may have an ownership interest in a rail authority, which operates as a GBE. The rail authority is allowed to operate autonomously and does not rely on the government for funding but has raised

capital through significant borrowings that are guaranteed by the government. The rail authority has not returned a dividend to government for several years. The government has the power to appoint and remove a majority of the members of the governing body of the rail authority. The government has never exercised the power to remove members of the governing body and would be reluctant to do so because of sensitivity in the electorate regarding the previous government's involvement in the operation of the rail network. In this case, the power to control is presently exercisable but under the existing relationship between the controlled entity and controlling entity, an event has not occurred to warrant the controlling entity exercising its powers over the controlled entity. Accordingly, control exists because the power to control is sufficient even though the controlling entity may choose not to exercise that power.

6. The existence of separate legislative powers does not, of itself, preclude an entity from being controlled by another entity. For example, the Office of Government Statistician usually has statutory powers to operate independently of the government. That is, the Office of Government Statistician may have the power to obtain information and report on its findings without recourse to government or any other body. The existence of control does not require an entity to have responsibility over the day-to-day operations of another entity or the manner in which professional functions are performed by the entity.
7. The power of one entity to govern decision-making in relation to the financial and operating policies of another entity is insufficient, in itself, to ensure the existence of control as defined in this Standard. The controlling entity needs to be able to govern decision-making so as to be able to benefit from its activities, for example by enabling the other entity to operate with it as part of an economic entity in pursuing its objectives. This will have the effect of excluding from the definitions of a "controlling entity" and "controlled entity" relationships which do not extend beyond, for instance, that of a liquidator and the entity being liquidated, and would normally exclude a lender and borrower relationship. Similarly, a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee would not be considered to control the trust for the purposes of this Standard.

Regulatory and Purchase Power

8. Governments and government entities have the power to regulate the behavior of many entities by use of their sovereign or legislative powers. Regulatory and purchase powers do not constitute control for the purposes of financial reporting. To ensure that the financial statements of a public sector entity include only those resources (cash, including cash equivalents) that it controls and can benefit from, the meaning of control for the purposes of this Standard does not extend to:
 - (a) The power of the legislature to establish the regulatory framework within which entities operate and to impose conditions or sanctions on their operations. Such power does not constitute control by a public sector entity

of the assets deployed by these entities. For example, a pollution control authority may have the power to close down the operations of entities that are not complying with environmental regulations. However, this power does not constitute control because the pollution control authority only has the power to regulate; or

- (b) Entities that are economically dependent on a public sector entity. That is, where an entity retains discretion as to whether it will take funding from, or do business with, a public sector entity, that entity has the ultimate power to govern its own financial or operating policies, and accordingly is not controlled by the public sector entity. For example, a government department may be able to influence the financial and operating policies of an entity which is dependent on it for funding (such as a charity) or a profit-orientated entity that is economically dependent on business from it. Accordingly, the government department has some power as a purchaser but not to govern the entity's financial and operating policies.

Determining Whether Control Exists for Financial Reporting Purposes

9. Public sector entities may create other entities to achieve some of their objectives. In some cases, it may be clear that an entity is controlled, and hence should be consolidated. In other cases it may not be clear. Paragraphs 10 and 11 below provide guidance to help determine whether or not control exists for financial reporting purposes.
10. In examining the relationship between two entities, control is presumed to exist when at least one of the following power conditions and one of the following benefit conditions exists, unless there is clear evidence of control being held by another entity.

Power conditions

- (a) The entity has, directly or indirectly through controlled entities, ownership of a majority voting interest in the other entity.
- (b) The entity has the power, either granted by or exercised within existing legislation, to appoint or remove a majority of the members of the governing body of the other entity.
- (c) The entity has the power to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of the other entity.
- (d) The entity has the power to cast the majority of votes at meetings of the board of directors or equivalent governing body.

Benefit conditions

- (a) The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations. For example, the benefit condition may be met if an entity had responsibility for the residual liabilities of another entity.
 - (b) The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.
11. When one or more of the conditions listed in paragraph 10 do not exist, the following factors are likely, either individually or collectively, to be indicative of the existence of control.

Power indicators

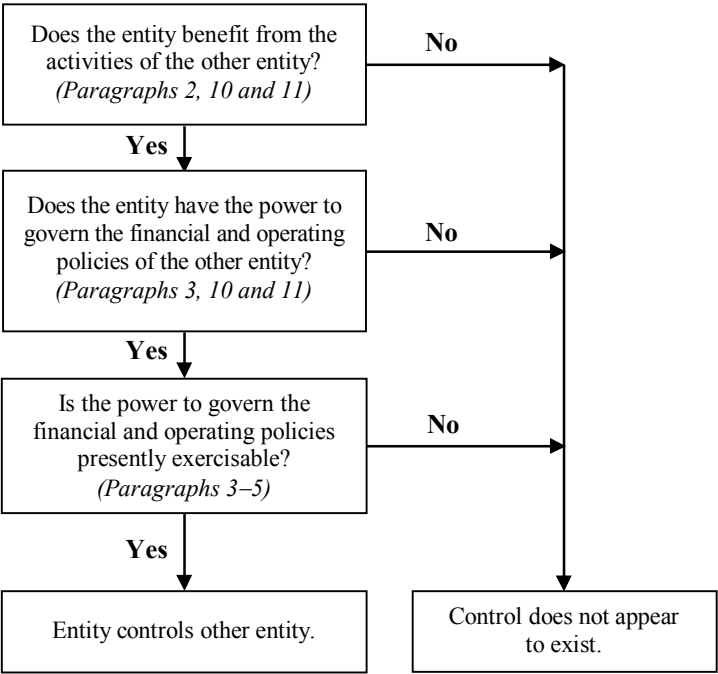
- (a) The entity has the ability to veto operating and capital budgets of the other entity.
- (b) The entity has the ability to veto, overrule, or modify governing body decisions of the other entity.
- (c) The entity has the ability to approve the hiring, reassignment and removal of key personnel of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

Benefit indicators

- (a) The entity holds direct or indirect title to the net assets/equity of the other entity with an ongoing right to access these.
 - (b) The entity has a right to a significant level of the net assets/equity of the other entity in the event of a liquidation or in a distribution other than a liquidation.
 - (c) The entity is able to direct the other entity to cooperate with it in achieving its objectives.
 - (d) The entity is exposed to the residual liabilities of the other entity.
12. The following diagram indicates the basic steps involved in establishing control of another entity. It should be read in conjunction with paragraphs 1 to 11 of this appendix.

¹ “Golden share” refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associated with the holder’s ownership interest or representation on the governing body.

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



13. Sometimes a controlled entity is excluded from consolidation when its activities are dissimilar to those of other entities within the economic entity, for example, the consolidation of GBEs with entities in the budget sector. Exclusion on these grounds is not justified because better information would be provided by consolidating such controlled entities and disclosing additional information in the consolidated financial statements about the different activities of controlled entities.

INTRODUCTION TO RECOMMENDED PRACTICE GUIDELINES

Recommended Practice Guidelines are developed and approved by the International Public Sector Accounting Standards Board (IPSASB).

The objective of the IPSASB is to serve the public interest by setting high-quality public sector accounting standards and by facilitating the adoption and implementation of these, thereby enhancing the quality and consistency of practice throughout the world and strengthening the transparency and accountability of public sector finances.

In meeting this objective the IPSASB sets International Public Sector Accounting Standards (IPSASs) and RPGs for use by public sector entities, including national, regional, and local governments, and related governmental agencies.

IPSASs relate to the general purpose financial statements (financial statements) and are authoritative. RPGs are pronouncements that provide guidance on good practice in preparing general purpose financial reports (GPFRs) that are not financial statements. Unlike IPSASs RPGs do not establish requirements. Currently all pronouncements relating to GPFRs that are not financial statements are RPGs. RPGs do not provide guidance on the level of assurance (if any) to which information should be subjected.

RPG 1—REPORTING ON THE LONG-TERM SUSTAINABILITY OF AN ENTITY’S FINANCES

History of RPG

RPG 1, *Reporting on the Long-Term Sustainability of an Entity’s Finances* was issued in July 2013.

REPORTING ON THE LONG-TERM SUSTAINABILITY OF AN ENTITY'S FINANCES

CONTENTS

	Paragraph
Objective	1
Status and Scope	2–8
Definitions	9
Determining Whether to Report Long-Term Fiscal Sustainability Information	10–13
Reporting Boundary	14–15
Reporting Long-Term Fiscal Sustainability Information	16–20
Presenting Projections of Future Inflows and Outflows	21–26
Time Horizon	25–26
Addressing the Dimensions of Long-Term Fiscal Sustainability	27–40
Service Dimension	31–34
Revenue Dimension	35–37
Debt Dimension	38–40
Principles and Methodologies	41–53
Updating Projections and Frequency of Reporting	41
Impact of Legal Requirements and Policy Frameworks	42
Current Policy, Demographic and Economic Assumptions	43–51
Current Policy Assumptions	43–49
Demographic and Economic Assumptions	50
Reasonableness of Assumptions	51
Inflation and Discount Rates	52
Sensitivity Analysis	53
Disclosures	54–58
Appendix A: Terms in this RPG Defined in IPSASs	
Appendix B: Relationship Between the Dimensions of Long-Term Fiscal Sustainability	

Objective

1. This Recommended Practice Guideline (RPG) provides guidance on reporting on the long-term sustainability of a public sector entity's finances ("reporting long-term fiscal sustainability information"¹). The RPG provides information on the impact of current policies and decisions made at the reporting date on future inflows and outflows and supplements information in the general purpose financial statements ("financial statements"). The aim of such reporting is to provide an indication of the projected long-term sustainability of an entity's finances over a specified time horizon in accordance with stated assumptions.

Status and Scope

2. The reporting of information in accordance with this RPG represents good practice. An entity reporting long-term fiscal sustainability information is encouraged to follow this RPG. Compliance with this RPG is not required in order for an entity to assert that its financial statements comply with International Public Sector Accounting Standards (IPSASs).
3. The scope of this RPG includes an entity's projected flows. It is not limited to those flows related to programs providing social benefits. Nevertheless, this RPG acknowledges that the flows relating to programs providing social benefits, including entitlement programs that require contributions from participants, can be a highly significant component of reporting long-term fiscal sustainability information for many entities.
4. This RPG does not directly address issues associated with the reporting of environmental sustainability. However, an entity should assess any financial impacts of environmental factors and take them into account when developing its projections.
5. This RPG is applicable to all public sector entities other than Government Business Enterprises (GBEs).
6. Although this RPG does not apply directly to GBEs, the future inflows and outflows related to a GBE, controlled by the reporting entity, over the specified time horizon of the projections are within the scope of this RPG.
7. Long-term fiscal sustainability information should not be described as complying with this RPG unless it complies with all the requirements of this RPG.

¹ The IPSASB acknowledges that in a number of jurisdictions the term "fiscal" has a narrow interpretation related to taxation. In this RPG the term is used with a broader meaning to include both inflows and outflows.

8. This RPG outlines minimum information levels. The RPG does not preclude the presentation of additional information if such information is useful in meeting the objectives of financial reporting and meets the qualitative characteristics (QCs) of financial reporting.

Definitions

9. The following terms are used in this RPG with the meaning specified:

Current policy assumptions are those assumptions based on legislation or regulation in force at the reporting date with appropriate departures for defined circumstances.

Inflows are cash and cash equivalents projected to be received or accrued by the entity over the time horizon of the projections.

Long-term fiscal sustainability is the ability of an entity to meet service delivery and financial commitments both now and in the future.

Outflows are cash and cash equivalents projected to be paid or accrued by the entity over the time horizon of the projections.

A projection is forward-looking financial information prepared on the basis of the entity's current policy assumptions, and assumptions about future economic and other conditions.

Terms used in this RPG with the meanings specified in International Public Sector Accounting Standards (IPSASs) are set out in Appendix A.

Determining Whether to Report Long-Term Fiscal Sustainability Information

10. In determining whether to report long-term fiscal sustainability information, an entity needs to assess whether potential users exist for prospective financial information.
11. Long-term fiscal sustainability information is broader than information derived from the financial statements. It includes projected inflows and outflows related to the provision of goods and services and programs providing social benefits using current policy assumptions over a specified time horizon. It therefore takes into account decisions made by the entity on or before the reporting date that will give rise to future outflows that do not meet the definition of and/or recognition criteria for liabilities at the reporting date. Similarly it takes into account future inflows that do not meet the definition of and/or recognition criteria for assets at the reporting date.
12. Assessments of long-term fiscal sustainability use a broad range of data. These data include financial and non-financial information about future economic and demographic conditions, assumptions about country and global trends such as productivity, the relative competitiveness of the national, state

or local economy and expected changes in demographic variables such as age, mortality, morbidity, fertility, gender, income, educational attainment and workforce participation.

13. The relevance of reporting long-term fiscal sustainability information should be considered in the context of that entity's funding and capacity to determine service delivery levels. There are likely to be users for long-term fiscal sustainability information for entities with one or more of the following characteristics:
 - (a) Significant tax and/or other revenue raising powers;
 - (b) Powers to incur significant debt; or
 - (c) The power and ability to determine the nature, level and method of service delivery including the introduction of new services.

Reporting Boundary

14. Use of the same reporting boundary as for the financial statements enhances the understandability of projections and increases their usefulness to the users of general purpose financial reports (GPFRs).
15. An entity may report long-term fiscal sustainability information using another reporting boundary, such as the General Government Sector (GGS). This may be to enhance consistency and comparability with other jurisdictions or because there are other indicators that are used to assess long-term fiscal sustainability based on another reporting boundary. Entities providing information on the GGS are encouraged to also present information in accordance with IPSAS 22, *Disclosure of Financial Information about the General Government Sector*.

Reporting Long-Term Fiscal Sustainability Information

16. Long-term fiscal sustainability information prepared in accordance with this RPG should enable users to assess various aspects of the long-term fiscal sustainability of the entity, including the nature and extent of financial risks that the entity faces.
17. The form and content of an entity's long-term fiscal sustainability information will vary depending on the nature of the entity and the regulatory environment in which it operates. A single presentation approach is unlikely to satisfy the objectives of financial reporting. To meet the objectives² and QCs of financial

² The objectives of financial reporting by public sector entities are to provide information about the entity that is useful to users of general purpose financial reports for accountability purposes and for decision-making purposes. See Chapter 2 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*) for further details.

reporting while taking into account the constraints³, long-term fiscal sustainability information will usually include the following components:

- (a) Projections of future inflows and outflows, which can be displayed in tabular statements or graphical formats, and a narrative discussion explaining the projections (see paragraphs 21–26 and 56);
 - (b) A narrative discussion of the dimensions of long-term fiscal sustainability including any indicators used to portray the dimensions (see paragraphs 27–40 and 57); and
 - (c) A narrative discussion of the principles, assumptions and methodology underlying the projections (see paragraphs 41–53 and 58).
18. The projections reported in long-term fiscal sustainability information generally reflect conditions of uncertainty. The projections are derived from models that rely on assumptions around which there is some uncertainty. In order for long-term fiscal sustainability information to faithfully represent an entity's projected future flows, assumptions used should be based on the best available information.
 19. Long-term fiscal sustainability information may be published as a separate report or as part of another report. It may be published at the same time as the entity's GPFs or at a different time.
 20. A controlled entity should ensure that the information reported is consistent with information reported by its controlling entity.

Presenting Projections of Future Inflows and Outflows

21. An entity should present projections of future inflows and outflows, including capital expenditure. The projections should be prepared on the basis of current policy assumptions, and assumptions about future economic and other conditions.
22. An entity should assess the extent to which it can draw on the assumptions, projections and indicators prepared by other entities, such as Ministries of Finance, or from other sources of information, rather than preparing the information itself, as this can reduce the cost of reporting. Such an assessment considers whether such information meets the QCs. Where an entity has a budget or forecast that meets the definition of a projection, this information can be used for the relevant time period or periods.

³ The qualitative characteristics of financial reporting are relevance, faithful representation, understandability, timeliness, comparability and verifiability. The constraints on information are materiality, cost-benefit and the balance between the qualitative characteristics. See Chapter 3 of the *Conceptual Framework* for further details.

23. Projections can be displayed in tabular statements or graphical formats providing details of the programs and activities giving rise to outflows and identifying the sources of inflows. In determining the format of tabular statements entities need to balance considerations of understandability and relevance. Presentation of a large number of time periods between the reporting date and the end of the time horizon provides a more complete information set, but increases the risk of information overload and the impairment of understandability.
24. An entity should ensure that its choice and presentation of projections is not skewed to present a misleadingly favorable or unfavorable picture. The formats and terms used should also be consistent between reporting periods.

Time Horizon

25. In selecting an appropriate time horizon an entity needs to balance the QCs of verifiability, faithful representation and relevance. The further the end of the time horizon is from the reporting date, the more future events are captured. However, as the time horizon increases, the assumptions underpinning the projections become less robust and potentially less verifiable. Conversely, excessively short time horizons may increase the risk that the consequences of events outside the time horizon may be ignored, thereby reducing the relevance of projections.
26. The length of the time horizon will reflect the characteristics of the entity. It is likely to be influenced by the characteristics of the entity, including aspects such as the longevity of key programs, the level of dependence on other entities for funding, the estimated lives of major items of property, plant, and equipment, such as infrastructure networks, and the time horizons adopted by other comparable entities providing prospective information.

Addressing the Dimensions of Long-Term Fiscal Sustainability

27. An entity reporting long-term fiscal sustainability information should include a narrative discussion on each of the dimensions of long-term fiscal sustainability. This RPG discusses three inter-related dimensions of long-term fiscal sustainability, as follows:
 - Service;
 - Revenue; and
 - Debt.
28. The dimensions are inter-related as changes in one dimension affect the other dimensions. For example, future services and entitlements to beneficiaries (the service dimension) are funded by revenue and/or debt. A single dimension can be analyzed by holding the other two dimensions constant. For example, by holding the existing levels of services and revenues constant an entity can

illustrate the effect of such assumptions on the level of debt. The relationships between the dimensions of long-term fiscal sustainability are illustrated in Appendix B.

29. There are two aspects to each dimension: capacity and vulnerability. Capacity is the ability of the entity to change or influence the dimension, and vulnerability is the extent of the entity's dependence on factors outside its control or influence.
30. An entity can use indicators to present the dimensions of long-term fiscal sustainability. An entity should choose its indicators based on their relevance to the entity. Examples of indicators are provided in the Glossary of Indicators in Appendix C.

Service Dimension

31. The service dimension considers the volume and quality of services to recipients and entitlements to beneficiaries over the period of the projections, given current policy assumptions on revenue from taxation and other sources, while remaining within debt constraints. This dimension focuses attention on the capacity of an entity to maintain or vary the volume and quality of services it provides or the entitlement programs it delivers. It also focuses attention on whether the entity is vulnerable to factors such as the willingness of recipients and beneficiaries to accept reductions in services and entitlements or vulnerable because it does not have the ability to determine or vary service levels, for example where another level of government determines the level of services to be provided.
32. By reflecting the impact of current policy assumptions on revenue from taxation and other sources, and on debt, long-term fiscal sustainability information can present the amounts available for the provision of goods and services. Users can contrast this information with the entity's service delivery commitments, and thereby evaluate the sustainability of the provision of services.
33. A factor to consider in making such comparisons is the extent to which expenditure on certain programs is likely to increase more steeply than the overall levels of expenditure of the entity. This may be because the number of beneficiaries is projected to increase for a particular program or because costs associated with certain programs, such as healthcare, are projected to increase more quickly than the general inflation rate. For example, due to demographic and technological changes, the cost of healthcare as a proportion of overall government expenditures might be projected to increase over the period of projections.
34. For capital intensive activities the service dimension also involves an assessment of the useful lives and replacement cycles of items of property, plant, and equipment.

Revenue Dimension

35. The revenue dimension considers taxation levels and other revenue sources over the period of the projections, given current policy assumptions on the provision of services to recipients and entitlements for beneficiaries, while remaining within debt constraints. This dimension focuses attention on the capacity of an entity to vary existing taxation levels or other revenue sources or introduce new revenue sources. It also focuses attention on factors such as whether the entity is vulnerable to the unwillingness of taxpayers to accept increases in taxation levels, and the extent of its dependence upon revenue sources outside its control or influence.
36. An example of an indicator of the revenue dimension is the proportion of total revenues that are received from entities at other levels of government or from international organizations. For example, a local government entity may be able to maintain or increase property taxes, but be partially dependent upon a mixture of general grants and specific grants from national and/or state governments. As policies for the provision of services and for managing debt are projected, the level of revenue required to fund such policies can be presented. This information assists users in assessing the entity's ability to maintain or increase its levels of revenue and thereby in evaluating the sustainability of its sources of revenue.
37. Generally, an entity which has a limited ability to vary levels of revenue from taxation and other sources is likely to be highly dependent upon funding decisions by entities at other levels of government. If inter-governmental transfers have constitutional or other legal underpinning, this may make the entity less susceptible to sudden adverse funding decisions by other entities and therefore increase the probability of continuing to receive stable revenues. This information assists users in assessing the entity's vulnerability to decisions outside its control.

Debt Dimension

38. The debt dimension considers debt levels over the period of the projections, given current policy assumptions on the provision of services to recipients and entitlements for beneficiaries, and revenue from taxation and other sources. This dimension focuses attention on the capacity of the entity to meet its financial commitments as they come due or to refinance or increase debt as necessary. It also focuses attention on whether the entity is vulnerable to market and lender confidence and interest rate risk.
39. The level of net debt is important for an assessment of the debt dimension, as, at any reporting date, it represents the amount expended on the past provision of goods and services that has to be financed in the future. Therefore, this indicator is likely to be relevant for many entities. By projecting current policy assumptions for the provision of goods and services, and for revenue

from taxation and other sources, projected levels of net debt can be presented. This information assists users in assessing the entity's ability to meet its financial commitments as they come due or to maintain, refinance or increase its levels of debt and thereby evaluate the sustainability of the entity's debt.

40. At national levels a factor to consider in presenting such projections is whether to distinguish between: (a) the primary balance, which is total projected government spending, excluding interest payable on debt, minus tax revenues, and (b) the overall balance, which is the primary balance including outflows related to interest payable on debt. At sub-national levels or for international organizations the focus may be on net debt as a percentage of total revenues. Increases in this indicator show that an increasing proportion of revenues will be required for debt servicing, thereby diverting resources from service delivery, and that the projected level of an entity's debt may be unsustainable.

Principles and Methodologies

Updating Projections and Frequency of Reporting

41. While regular updates are desirable, this RPG acknowledges that annual updating may not be realistic for all entities. However, there is generally an inverse relationship between the robustness of assumptions on which projections are made and the amount of time since they were made. During periods of global financial volatility the risk of projections made some time before the reporting date becoming outdated increases, with a consequent reduction of the ability of such information to meet the objectives of accountability and decision making. In this situation, an entity should consider updating its projections on a more frequent basis. An entity should also consider updating its projections after significant or major unexpected events such as natural disasters or other emergencies.

Impact of Legal Requirements and Policy Frameworks

42. In some jurisdictions reporting long-term fiscal sustainability information is governed by a legal or regulatory framework that applies at the national or state level or through international arrangements. There may also be legal requirements for local government. These might include balanced budget requirements. These requirements are likely to specify or otherwise affect the principles, assumptions and methodologies an entity should use in calculating and disclosing its projections.

Current Policy, Demographic and Economic Assumptions

43. Where flows for particular programs and activities are individually modeled, the policy assumptions should be based on the continuation of current legislation or regulation with departures where appropriate. Those assumptions (referred to as "current policy assumptions") should be applied

consistently through-out the entire projection period. The starting point for current policy assumptions should be legislation or regulation currently in force. However, there may be instances where a departure from current legislation or regulation may be appropriate, for example:

- (a) Where changes to current legislation or regulation have been enacted before the reporting date, and where those changes have a specific implementation date within the time horizon of the projections;
- (b) Where the provisions in current legislation or regulation are internally inconsistent; or
- (c) Where current legislation or regulation has a termination date, e.g., "sunset provisions".

- 44. Current policy assumptions may be affected by legal changes that have been enacted before the reporting date, which have a specific implementation date within the time horizon of the projections. In these circumstances, assuming current legislation or regulation remains in force for the entire projection period will not be appropriate.
- 45. An example of current legislation or regulation that is internally inconsistent is a social security program which has legal provisions that make it unlawful to make payments once an earmarked fund is exhausted, although entitlements of beneficiaries will continue after the exhaustion of that fund. Assuming that the fund will not meet obligations once it is exhausted might reflect a strict legal position, but an entity may need to assess whether the presentation of projections on such a basis underestimates projected outflows and therefore the extent of the fiscal challenge facing the social security program. In this situation an entity may calculate its projections based on current policy assumptions despite legal restrictions.
- 46. Current legislation or regulation may have a termination date, e.g., sunset provisions, whereby it terminates after a specific period. In many cases there may be a strong probability that such programs will be replaced by similar programs. Adopting a strict legal termination principle could underestimate projected outflows, and therefore impair the usefulness of the information.

Approach to Revenue Inflows

- 47. Significant revenue inflows from taxation and other sources, such as inter-governmental transfers, may be individually modeled based on current policy assumptions. Significant sources of taxation and other revenue inflows that are not modeled individually are projected to grow (or diminish) in relation to a variable such as gross domestic product (GDP) or a specified inflation index.
- 48. Other revenue inflows, such as royalties from natural resources, may also be projected to grow in line with GDP or an index. They may also be

individually modeled to address specific circumstances, such as when the natural resource is expected to be depleted.

Approach to Age-Related and Non-Age-Related Programs

49. Age-related programs are often subject to eligibility criteria such as age and other demographic factors. In making projections, programs and activities that are age-related may be distinguished from non-age-related programs. Age-related programs may be individually modeled while non-age-related programs may be projected to increase in line with other variables, such as GDP, or to be constant in real terms. Such an approach to non-age-related programs provides some flexibility, as it allows above GDP/real terms increases in some programs and activities to be offset by lower increases or spending declines in other areas.

Demographic and Economic Assumptions

50. Demographic assumptions are likely to include fertility, mortality and migration rates, and workforce participation rates. Economic assumptions are likely to include economic growth rates and inflation. Other economic assumptions may include environmental factors, such as the impact of the depletion and degradation of ecosystems and the depletion of water and finite natural resources on economic growth.

Reasonableness of Assumptions

51. Projections of inflows and outflows should be based on current policy assumptions and economic and demographic assumptions, which are reasonable in the context of the factors discussed in paragraph 18.

Inflation and Discount Rates

52. There are two main approaches to incorporating the effect of price inflation in projections. Inflation may be taken into account in making projections or projections may be made at current prices (i.e., prices prevailing at the reporting date). If the projections include inflation, then the discount rate should also include inflation. If the projections are at current prices, the discount rate should exclude inflation.

Sensitivity Analysis

53. Many assumptions on which projections are based are inherently uncertain. In some cases small changes in variables can have significant impacts on the projections. The use of sensitivity analysis will help users to understand the impact of significant changes in demographic and economic assumptions on the projections.

Disclosures

54. The entity should disclose information that enables users of its long-term fiscal sustainability information to assess the projected long-term fiscal sustainability of the entity. An entity should make any additional disclosures necessary to meet the objectives of financial reporting.
55. An entity should disclose the following information:
 - (a) The name of the entity;
 - (b) The financial statements to which the long-term fiscal sustainability information relates;
 - (c) Where different, the names of the entities within the reporting boundary for long-term fiscal sustainability information that are different to those for the financial statements;
 - (d) Where the entity is a controlled entity, the identity of the controlling entity;
 - (e) The date at which a full set of projections was made;
 - (f) The basis and timing of subsequent updating of that full set of projections; and
 - (g) When an entity uses projections and indicators prepared by other entities or from other sources of information, the names of those entities or other sources, and the information that has been used.
56. The narrative discussion of the projections should include disclosure of the following information:
 - (a) The sources of significant revenue inflows from taxation and other sources;
 - (b) An overview of the current policy assumptions for significant revenue inflows from taxation and other sources, such as taxation threshold levels and allowances;
 - (c) The sources of significant outflows including capital expenditure;
 - (d) An overview of the current policy assumptions for the significant outflows including capital expenditure;
 - (e) Whether the projections are modeled individually or in aggregate;
 - (f) An explanation of the changes in projections between reporting dates and the reasons for those changes;
 - (g) An explanation that projections are not forecasts and that it is unlikely that projections over the specified time horizon will match the actual outcome and the extent of the difference will depend upon a range of

- factors, including the future actions of the entity in meeting any identified fiscal challenge;
- (h) An explanation of any modifications of formats between reporting periods and the reasons for such changes;
 - (i) The time horizon used for the projections and the reasons for selecting that time horizon; and
 - (j) Where an entity changes the time horizon from that used in the previous reporting period, the reason for such a change.
57. The narrative discussion of the dimensions of long-term fiscal sustainability should include disclosure of the following information:
- (a) An analysis of significant changes in the indicators compared with those of the previous reporting period;
 - (b) Changes in the indicators used to report long-term fiscal sustainability information from the previous reporting period, and the reasons for such changes; and
 - (c) Where an entity uses indicators that are based on amounts derived from non-IPSAS-based information and the indicators affected.
58. An entity should disclose the principles, assumptions and methodology that underpin the projections including the following information:
- (a) Key aspects of governing legislation and regulation;
 - (b) Underlying macro-economic policy and fiscal frameworks, including details of where other publicly available reports on these policies and frameworks can be accessed, including documents outside the GPFs;
 - (c) The key current policy assumptions and the key demographic and economic assumptions that underpin the projections;
 - (d) Its policy for reviewing and updating current policy assumptions and, demographic and economic assumptions;
 - (e) An explanation of any significant current policy assumptions that depart from current legislation or regulation;
 - (f) An explanation of significant changes in the principles, assumptions and methodologies from the previous reporting period, the nature and extent of these changes, and the reasons for such changes;
 - (g) The results of any sensitivity analyses that could have a significant impact on the projections;
 - (h) The discount rates applied and the basis on which the discount rate has been determined; and

- (i) The approach to inflation and the reason for this approach.

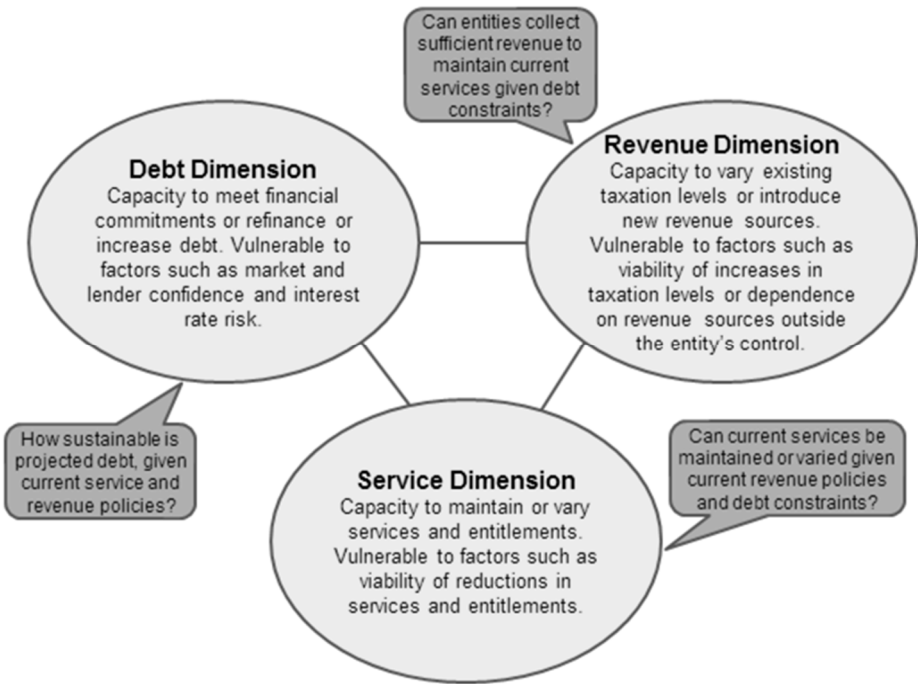
Appendix A**Terms in this RPG Defined in IPSASs**

Term	Definition
Assets	Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.
Cash	Comprises cash on hand and demand deposits.
Cash equivalents	Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
Controlled entity	An entity, including an unincorporated entity such as a partnership, which is under the control of another entity (known as the controlling entity).
Controlling entity	An entity that has one or more controlled entities.
Government Business Enterprise	An entity that has all the following characteristics: <ul style="list-style-type: none"> (a) Is an entity with the power to contract in its own name; (b) Has been assigned the financial and operational authority to carry on a business; (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery; (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and (e) Is controlled by a public sector entity.
General government sector	Comprises all organizational entities of the general government as defined in statistical bases of financial reporting.
Liabilities	Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.
Reporting date	The date of the last day of the reporting period to which the financial statements relate.
Revenue	The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.

Appendix B

Relationships Between the Dimensions of Long-Term Fiscal Sustainability

This Appendix illustrates the two aspects (capacity and vulnerability) of each of the three dimensions and the relationship between the three dimensions.



Appendix C

Glossary of Indicators

This Appendix lists examples of indicators. It is not intended to be an exhaustive list.

Government Finance Statistics Reporting Guidelines

Where an indicator includes a defined term, that term is shown in *italics* and its definition is shown after the indicators.

- **Gross debt, total:** Total gross debt—often referred to as “total debt” or “total debt liabilities”—consists of all *liabilities* that are *debt instruments*. A debt instrument is defined as a financial claim that requires payment(s) of interest and/or principal by the debtor to the creditor at a date, or dates, in the future.⁴
- **Net debt:** Net debt is calculated as gross debt minus *financial assets* corresponding to *debt instruments*.⁴
- **Net financial worth:** Net financial worth of an *institutional unit* (or grouping of units) is the total value of its *financial assets* minus the total value of its outstanding *liabilities*.⁴
- **Net worth:** Net worth of an *institutional unit* (or grouping of units) is the total value of its *assets* minus the total value of its outstanding *liabilities*.⁴
- **Overall balance:** This term corresponds to the GFS 1986 terminology of “Overall Deficit/Surplus,” which is defined as revenue plus grants received less expenditure less “lending minus repayments.” The balance so defined is equal (with an opposite sign) to the sum of net borrowing by the government, plus the net decrease in government cash, deposits, and securities held for liquidity purposes. The basis of this balance concept is that government policies are held to be deficit- or surplus-creating, and thus the revenue or expenditures associated with these policies are “above the line.” Borrowing or a rundown of liquid assets, however, is deficit financing or “below the line.” It should be noted that the term “lending minus repayments” included above the line covers government transactions in debt and equity claims on others undertaken for purposes of public policy rather than for management of government liquidity or earning a return.⁵
- **Primary balance:** The overall balance, excluding interest payments. Since interest payments represent the cost of past debt, and the determinants of future debt that are under policy control of government are other spending and

⁴ Source: International Monetary Fund: *Public Sector Debt Statistics—Guide for Compilers and Users* 2011.

⁵ Source: International Monetary Fund: *Manual on Fiscal Transparency* (2007).

revenue measures exclusive of interest payment, the primary balance is of particular importance as an indicator of the fiscal position in countries with high levels of debt.⁵

Underlying Definitions

- **Debt instrument:** A debt instrument is defined as a financial claim that requires payment(s) of interest and/or principal by the debtor to the creditor at a date, or dates, in the future.⁴
- **Economic assets:** Economic assets are entities (i) over which economic ownership rights are enforced by institutional units, individually or collectively, and (ii) from which economic benefits may be derived by their owners by holding them or using them over a period of time.⁴
- **Financial assets:** Financial assets consist of financial claims plus gold bullion held by monetary authorities as a reserve asset. A financial claim is an asset that typically entitles the owner of the asset (the creditor) to receive funds or other resources from another unit, under the terms of a liability.⁶
- **Institutional unit:** An institutional unit is an economic entity that is capable, in its own right, of owning assets, incurring liabilities, and engaging in economic activities and in transactions with other entities.⁶
- **Liability:** A liability is established when one unit (the debtor) is obliged, under specific circumstances, to provide funds or other resources to another unit (the creditor).⁶

Other Sources

- **Fiscal gap:** The fiscal gap is the change in non-interest spending and/or receipts that would be necessary to maintain public debt at or below a target percentage of gross domestic product (GDP).⁷ More specifically, the fiscal gap is the net present value of projected spending⁸ minus projected receipts, adjusted by the decrease (or increase) in public debt required to maintain public debt at or below the target percentage of GDP for the stated projection period. (Source: US Federal Accounting Standards Advisory Board: Statement of Federal Financial Accounting Standards 36: *Comprehensive Long-Term Projections for the U.S. Government* 2009).

⁶ Source: International Monetary Fund: *Public Sector Debt Statistics—Guide for Compilers and Users* 2011.

⁷ GDP is the total market value of all final goods and services produced domestically during a given period of time. The components of GDP are: private sector consumption and investment, government consumption and investment, and net exports (exports-imports).

⁸ Since interest is factored into the present value calculation, the fiscal gap as a share of spending is expressed as a share of spending excluding interest (“non-interest spending”).

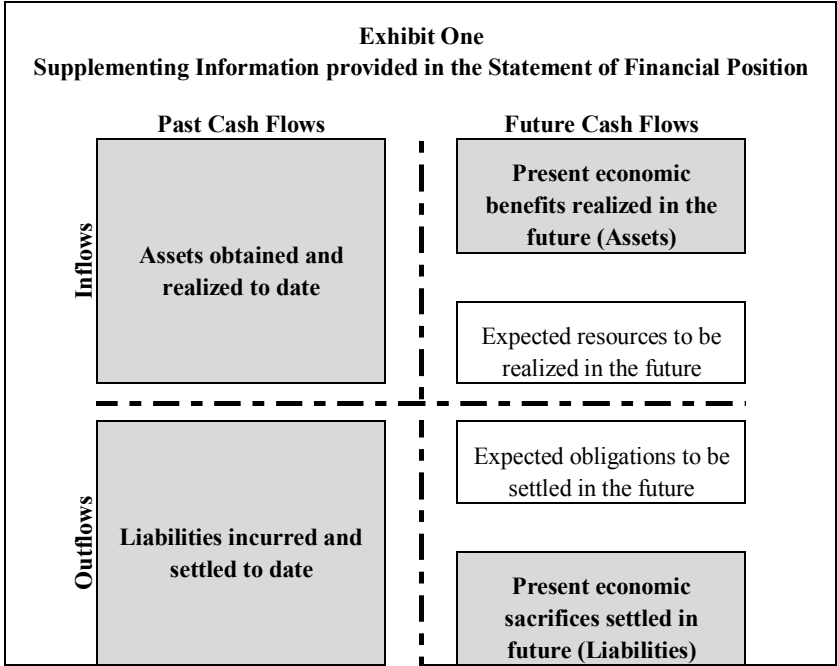
- **Inter-temporal budget constraint:** The inter-temporal budget constraint is satisfied if the projected outflows of the government (current public debt and the discounted value of all future expenditure, including the projected increase in age-related expenditure) are covered by the discounted value of all future government revenue. (Source European Commission: *Sustainability Report*: 2009).
- **Net Debt/Total Revenues:** Net debt as a proportion of total revenues. (Source Canadian Public Sector Accounting Board (PSAB): Statement of Recommended Practice 4 (SORP 4), *Indicators of Financial Condition*: 2009).

Basis for Conclusions

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

Background

- BC1. The IPSASB initially launched a project on accounting for social policy obligations (subsequently re-termed social benefits) in 2002. This led to the publication of an Invitation to Comment (ITC), *Accounting for Social Policies of Governments*, in January 2004. Following an analysis of responses to that ITC, the IPSASB began to develop proposals for accounting for obligations related to different sub-categories of social benefits. In late 2006, due to failure to agree on recognition points and measurement requirements for liabilities, the IPSASB decided not to develop further proposals on recognition and measurement at that time.
- BC2. As an interim step the IPSASB developed proposals for the disclosure of amounts to be transferred to those eligible at the reporting date for cash transfers (benefits settled in cash). It expressly did not propose the disclosure of obligations and liabilities. ED 34, *Social Benefits: Disclosure of Cash Transfers to Individuals or Households*, was issued in March 2008.
- BC3. The deliberations on identifying the point at which liabilities for social benefits arise had led the IPSASB to the view that the financial statements cannot provide all the information that users need on social benefits. This is illustrated in Exhibit One below where the shaded boxes indicate information provided in the financial statements. The IPSASB considered that before launching any further project it should consult constituents. Therefore the IPSASB raised this issue in a further Consultation Paper, *Social Benefits: Issues in Recognition and Measurement*, and issued a Project Brief, *Long-Term Fiscal Sustainability Reporting*. Both these documents were issued at the same time as ED 34.



BC4. In October 2008 the IPSASB reviewed responses to all of the above documents. In the light of these responses, it was decided not to develop ED 34 into an IPSAS. The IPSASB also noted that a large majority of respondents agreed that the financial statements cannot convey sufficient information to users about the long-term financial implications of governmental programs providing social benefits.⁹ In light of this view the IPSASB decided to initiate a project on long-term fiscal sustainability (subsequently re-termed “Reporting on the Long-Term Sustainability of Public Finances”). This led to the issue of a Consultation Paper, *Reporting on the Long-Term Sustainability of Public Finances*, in November 2009. Drawing on existing practice the Consultation Paper put forward the case for reporting long-term fiscal sustainability information, made suggestions on how such information might be presented and sought the views of constituents. The majority of respondents to the Consultation Paper favored the continuation of the project, although many said that they preferred the IPSASB to develop guidelines rather than requirements.

⁹ Further work on proposals for the recognition and measurement of liabilities arising from obligations to deliver social benefits has progressed indirectly in Phase 2 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* project. This phase deals with elements, and includes the development of the definition of a liability and other relevant issues such as whether the power to tax is an asset. This work is likely to influence the approach to recognizing and measuring liabilities related to social benefits. The IPSASB decided to reactivate its project on social benefits at its June 2013 meeting.

- BC5. In light of the responses to the Consultation Paper, the IPSASB developed ED 46. RPG, *Reporting on the Long-Term Sustainability of a Public Sector Entity's Finances*, which was issued in October 2011. This ED proposed non-authoritative guidance for public sector entities reporting long-term fiscal sustainability information.
- BC6. The IPSASB has further developed its thinking on reporting long-term fiscal sustainability information in the course of its project on *The Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* and, in particular, in Chapter 2 of that Framework. Chapter 2: *Objectives and Users of General Purpose Financial Reporting* reflects the view that, although the financial statements are at the core of financial reporting, a more comprehensive scope is necessary to meet the needs of users. That scope includes prospective financial information. The IPSASB has also noted that projected outflows relating to obligations as a result of past decisions and projected inflows related to sovereign powers and taxation powers may not be recognized or may only be partially recognized in the statement of financial position and the statement of financial performance. Therefore, in order to meet the financial reporting objectives of accountability and decision making, an entity should provide users with information on future inflows and outflows that supplements information on the entity's financial position in the financial statements.
- BC7. The IPSASB acknowledges that the rationale for reporting long-term fiscal sustainability information in paragraph BC6 might indicate that for some entities such reporting should be required. However, the IPSASB concluded that it would be premature to issue an authoritative pronouncement, because reporting long-term fiscal sustainability information in GPFs is an area where practice is developing and the IPSASB wishes to encourage innovative and flexible approaches. This approach is consistent with the views of the majority of respondents to ED 46. The IPSASB notes that paragraph 4 of the RPG notes that it is good practice to follow this RPG.

Scope

- BC8. The IPSASB considered whether the scope of the RPG should be limited to the consolidated national and whole-of-government levels. The IPSASB acknowledged that reporting long-term fiscal sustainability information is particularly relevant at these levels, but concluded that there might be significant user demand for such information at sub-national levels. The IPSASB therefore concluded that a narrow scope limited to the national and whole-of-government levels is not justified. The factors considered by the Board in determining whether an entity should report long-term fiscal sustainability information are discussed in paragraphs BC14-BC17.

Definitions

Long-Term Fiscal Sustainability

BC9. The Consultation Paper noted that there is no universally accepted definition of long-term fiscal sustainability and included a working definition that long-term fiscal sustainability is “the ability of government to meet its service delivery and financial commitments both now and in the future.” The IPSASB acknowledged the view that this definition is insufficiently rigorous and that a definition should be adopted that provides users with a clearer indication whether an entity’s current economic position is sustainable. Such an approach might involve (a) linking current service delivery obligations to the maintenance of current taxation levels and (b) focusing on projected debt paths. An entity that can only meet current service delivery obligations and financial obligations by increasing taxation or current debt levels is identified as being in an unsustainable position. Macro-economists tend to adopt this more rigorous approach and focus on “explosive” debt paths, which is a term that connotes that existing service levels and existing benefits from entitlement programs cannot be sustained without major increases in levels of indebtedness.

BC10. The IPSASB decided to retain the definition of long-term fiscal sustainability used in the Consultation Paper for ED 46 and subsequently for this RPG, except for widening the scope to reflect that it can apply to all public sector entities (except Government Business Enterprises) rather than limiting it to governments. In coming to this conclusion the IPSASB noted the need for governments and public sector entities to both (a) provide services and meet obligations relating to entitlement programs and (b) meet financial obligations, principally debt servicing. The IPSASB also noted that many governments have sovereign powers to enact legislation for new taxation sources and to vary the levels of existing taxation, while acknowledging that in a global environment the ability to increase taxation might be practically constrained by a number of considerations. The IPSASB took the view that, provided an entity gives appropriate attention to the dimensions of long-term fiscal sustainability, as explained in paragraphs 27–40, users will be given adequate information about whether an entity can maintain existing service levels, meet obligations to the current and future beneficiaries of entitlement programs and meet financial obligations without increasing revenue from taxation and other sources or increasing borrowing.

Projections, Forecasts and Budgets

BC11. Several respondents to ED 46 suggested that the relationship between projections, forecasts and budgets should be clarified. Given that there are no universally accepted definitions of these terms, the IPSASB decided to develop a definition of a projection to clarify the characteristics of information

that should be used in calculating the projections and to ensure that only calculations that meet these characteristics are within the scope of the RPG.

BC12. In developing its definition of a projection the IPSASB considered whether forward-looking financial information should be based on a strict adherence to legislation or regulation in force at the reporting date, or whether specific departures from legislation or regulation in force at the reporting date might be appropriate. The IPSASB recognized that there may be limited cases where departures from current legislation or regulation may be appropriate in order to provide more relevant information. A projection is therefore defined as “forward-looking financial information prepared on the basis of the entity’s current policy assumptions, and assumptions about future economic and other conditions.” Current policy assumptions are those “assumptions based on legislation or regulation in force at the reporting date with appropriate departures for defined circumstances.” Circumstances where departures from current legislation or regulation are appropriate are detailed in paragraph 43 and discussed in paragraphs BC31-34.

BC13. Budgets and forecasts aim to provide details of intended outcomes. In contrast projections are not intended to provide approximations of actual outcomes. A budget is a plan of an entity’s anticipated revenues or receipts and anticipated expenses or expenditure over a specified period. It may be related to service outputs or outcomes in the period. A forecast provides prospective information that includes anticipated actions and interventions by the entity although these may not be reflected in current legislation or regulation or within the limited departures inherent in the definition of a projection. The IPSASB agreed that some of the information in budgets or forecasts might also be used for projections.

Determining Whether to Report Long-Term Fiscal Sustainability Information

BC14. As discussed in paragraph BC8 the IPSASB concluded that the scope of the RPG should not be limited to particular levels of government. However, the IPSASB acknowledged that reporting long-term fiscal sustainability information might not be appropriate for all entities.

BC15. The Consultation Paper questioned whether reporting long-term fiscal sustainability information is appropriate for individual controlled entities. This reservation was based on a tentative view that (a) the cost of producing the information for such entities is likely to be greater than the benefits to users, (b) the production of separate reports and disclosures by individual entities within an economic entity might be confusing to users and (c) it could be misleading if entities with limited tax-raising powers and a dependence on resources from entities at other tiers of government provide projections that are contingent on taxation decisions over which they have little or no control. Some respondents to the Consultation Paper challenged this view and suggested that there are cases where users for long-term fiscal sustainability

information of controlled entities can be identified. The example of a local government entity controlled by a state or provincial government was cited. These respondents proposed that the test for whether an entity reports long-term fiscal sustainability information should be to assess whether potential users exist for this type of information. The IPSASB was persuaded by these arguments and the RPG reflects these views in paragraphs 12 and 13.

BC16. The IPSASB acknowledged that direct evidence of the existence of users of long-term fiscal sustainability information might not be readily available. The IPSASB sought to identify characteristics which might indicate the existence of users across the three dimensions of long-term fiscal sustainability. The IPSASB had reservations about whether there would be significant numbers of users to justify the costs of reporting if entities did not have one or more of the following characteristics:

- (a) Significant tax and/or other revenue raising powers;
- (b) Powers to incur significant debt; or
- (c) The power and ability to determine the nature, level and method of service delivery including the introduction of new services.

BC17. The IPSASB believes that reporting long-term fiscal sustainability information is likely to be relevant at the whole of government level, consolidated national level, and for major sub-national entities such as regions, provinces, states and large local government entities (for examples, cities), which have tax raising powers enabling them to generate a significant proportion of their total revenues. The IPSASB remains of the view that reporting long-term sustainability information is unlikely to be appropriate for individual government departments and entities. This is because often they do not have tax raising powers, their expenditure is controlled through appropriations, and they do not have powers to incur debt.

Presenting Projections of Future Inflows and Outflows

BC18. The Consultation Paper considered three models for reporting long-term fiscal sustainability information and suggested that (a) the provision of additional statements providing details of projections and (b) summarized projections in narrative reporting were appropriate. Some respondents suggested that, although the Consultation Paper acknowledged that these reporting approaches were not mutually exclusive, the IPSASB should highlight that reporting long-term fiscal sustainability information just by displaying projections in statements is insufficient to meet user needs and that other presentation methods need to be deployed. The IPSASB was persuaded by this view and agreed to reflect this in paragraph 17 of the RPG).

BC19. The IPSASB considered whether it should recommend time horizons for projections for entities at particular levels of government. It acknowledged the

view that standard time horizons for particular types of public sector entity might enhance comparability. The IPSASB decided that such benchmarks would be over-prescriptive and impractical. The scope of the RPG is such that standard time horizons would have to be determined for a wide range of entities, including individual reporting entities.¹⁰ In addition the fiscal autonomy of entities at the same level of government can differ markedly between jurisdictions. The IPSASB concluded, however, that it is good practice for entities to explain the reason for the time horizons that they select. The IPSASB considers that the extent of an entity's dependence on other entities for funding will have an impact on time horizons; the higher the level of dependence, the higher the likelihood of shorter time horizons.

BC20. The Consultation Paper included illustrative examples of tabular statements showing 75 year projections for key programs and activities. The IPSASB noted the view of some respondents that a focus on the position at the end of the time horizon may obscure events between the reporting date and the end of the time horizon. The IPSASB accepted this view and included guidance on the need to balance the QCs of verifiability, faithful representation and relevance in displaying projections in paragraph 25 of the RPG.

Addressing the Dimensions of Long-Term Fiscal Sustainability

BC21. The IPSASB considered that providing a flexible framework for the disclosure of information might help entities to organize the way in which they communicate information and ensure that information is a faithful representation of an entity's long-term fiscal sustainability information.

BC22. ED 46 included three dimensions of long-term fiscal sustainability, as follows:

- Fiscal capacity;
- Service capacity; and
- Vulnerability.

BC23. The description of vulnerability was derived from the definition of vulnerability in Statement of Recommended Practice 4 (SORP-4), *Indicators of Financial Condition* issued by the Canadian Public Sector Accounting Board (PSAB). The definition in SORP-4 is "the degree to which a government is dependent on sources of funding outside its control or influence or is exposed to risks that could impair its ability to meet its existing financial obligations both in respect of its service commitments to the public and financial commitments to creditors, employees and others." The IPSASB considered that a variant of this notion is particularly important for entities at sub-national levels which have limited taxation powers and are therefore

¹⁰ For example, such entities might include school boards or bodies responsible for water and drainage.

exposed to decisions, over which they have no or very limited control, taken by other entities at other levels of government.

BC24. The descriptions of the other two dimensions in ED 46 were derived from the US Governmental Accounting Standards Board's (GASB)¹¹ definitions of "fiscal capacity" and "service capacity." The GASB defines fiscal capacity as "the government's ability and willingness to meet its financial obligations as they come due on an ongoing basis" and service capacity as "the government's ability and willingness to meet its commitments to provide services on an ongoing basis."

BC25. When developing the RPG based on ED 46, the IPSASB considered whether the notion of vulnerability in the ED was too narrow and whether vulnerability is a more pervasive factor in the analysis of the long-term fiscal sustainability of an entity's finances. The IPSASB concluded that vulnerability is an aspect of all three dimensions. Therefore, the IPSASB decided to (a) explain how the notion of vulnerability affects each dimension of long-term fiscal sustainability and (b) change the name of the vulnerability dimension to the revenue dimension because its description relates to changes in revenues.

BC26. The IPSASB also noted that the dictionary definition of "fiscal" includes revenue¹² while the description of fiscal capacity relates to the ability of the entity to meet financial commitments, in other words, its ability to maintain and service its debt. Therefore the IPSASB decided that the name of this dimension should be changed to the debt dimension to more closely reflect the description. The renaming of these two dimensions required a modification to the service capacity dimension so that the wording of the three dimensions is consistent. The IPSASB acknowledged that the dimensions are inter-related.

BC27. The IPSASB noted that the approach taken by the PSAB and the GASB had similarities to the "dimensions" of sustainability developed by Allen Schick¹³ and discussed in the Consultation Paper.

BC28. One of the dimensions that Schick discussed was "economic growth." The IPSASB considered that explicitly introducing a dimension of economic growth was inappropriate because the determinants of economic growth are complex and not under the control of the reporting entity. However,

¹¹ *Preliminary Views of the Governmental Accounting Standards Board on Major Issues related to Economic Condition Reporting: Financial Projections*. (Governmental Accounting Standards Board: Norwalk, CT, USA, November 2011).

¹² The definition of fiscal is "of or relating to taxation, public revenues, or public debt" (Webster's Ninth New Collegiate Dictionary, 1984).

¹³ Allen Schick, *Sustainable Budget Policy: Concepts and Approaches* (OECD: Paris, 2005).

assumptions about economic growth will be critical to the development of projections and are likely to feature heavily in sensitivity analyses.

Principles and Methodologies

BC29. The Consultation Paper discussed the principles that should be adopted for the inclusion of programs and activities in reporting long-term fiscal sustainability information and methodologies central to the outcome of projections. The areas addressed included whether projections should be based on current or future policy, the approach to revenue inflows, the approach to age-related and non-age-related programs and the approach to sensitivity analysis. The IPSASB considered whether, in order to meet the qualitative characteristic of comparability, the IPSASB should make firm recommendations on good practice.

BC30. The IPSASB did not consider it appropriate to make firm recommendations on good practice because (a) the scope of the RPG includes all public sector entities and practice that is appropriate at one level of government may not be suitable elsewhere in the public sector, (b) while reporting long-term fiscal sustainability information has become a feature of financial management in an increasing number of jurisdictions it is at an early stage of development and (c) it is not the intention of the IPSASB to usurp the role of other professional groups with expertise in this area. In some cases the IPSASB has considered it appropriate to express a view on a preferred high level approach. For example, the IPSASB has taken the view that projections are likely to be most useful when they are based on current policy assumptions and encompass both inflows as well as outflows. The IPSASB also noted that, at the national level, the Organisation for Economic Cooperation and Development has recommended that projections should be updated on an annual basis.

Current Policy Assumptions

BC31. Paragraphs 40–42 of ED 46 explained that an entity can depart from using current policy to calculate its projections (a) where there is a conflict between current policy and legal obligations and (b) where a policy has “sunset provisions.”

BC32. The IPSASB introduced the term “current policy assumptions” to clarify that current policy means current legislation or regulation with departures where appropriate. Current policy assumptions are applied to the entire projection period for inflows or outflows that are individually projected. The RPG gives examples of where a departure may be appropriate in paragraphs 44–46. The IPSASB noted that paragraph 58(e) of the RPG recommends that any departures from current legislation or regulation be disclosed together with the reasons for such departures.

BC33. A respondent to ED 46 raised a concern that the concept of current policy should be broader than that proposed in the ED to deal with issues such as

fiscal drag. Fiscal drag refers to the phenomenon that income tax inflows grow faster than the income it is levied on because, as an individual's income grows, an increasing proportion of it is taxed at a higher rate. Fiscal drag occurs if the rates and thresholds for the taxation of individuals are not adjusted over time, and is often addressed by governments through periodic increasing of tax thresholds.

- BC34. The IPSASB concluded that the issue of fiscal drag is addressed in paragraph 47 of the RPG because it permits current policy assumptions to be applied to the demographic and economic assumptions, including assumptions over inflation. When a flow such as tax is modeled it may be based on a percentage of a variable such as GDP or reflect the application of current policy assumptions to the changing circumstances reflected in the demographic and economic assumptions.

RPG 2—FINANCIAL STATEMENT DISCUSSION AND ANALYSIS

History of RPG

RPG 2, *Financial Statement Discussion and Analysis* was issued in July 2013.

FINANCIAL STATEMENT DISCUSSION AND ANALYSIS

CONTENTS

	Paragraph
Objective	1
Status and Scope	2–8
Definition	9
Identification of Financial Statement Discussion and Analysis	10–12
Presenting Financial Statement Discussion and Analysis	13–14
Content of Financial Statement Discussion and Analysis	15–31
Overview of the Entity’s Operations and Environment	19
Information about the Entity’s Objectives and Strategies	20–21
Analysis of the Entity’s Financial Statements	22–26
Risks and Uncertainties	27–31
Appendix A: Terms in this RPG Defined in IPSASs	
Basis for Conclusions	

Objective

1. This Recommended Practice Guideline (RPG) provides guidance for preparing and presenting financial statement discussion and analysis. Financial statement discussion and analysis will assist users to understand the financial position, financial performance and cash flows presented in the general purpose financial statements (hereafter referred to as “financial statements”).

Status and Scope

2. The reporting of information in accordance with this RPG represents good practice. An entity preparing and presenting financial statement discussion and analysis is encouraged to follow this RPG. Compliance with this RPG is not required in order for an entity to assert that its financial statements comply with International Public Sector Accounting Standards (IPSASs).
3. Financial statement discussion and analysis should be presented at least annually and should use the same reporting period as that covered by the financial statements.
4. The reporting boundary for financial statement discussion and analysis should be the same as that used for the financial statements.
5. Financial statement discussion and analysis should be issued with the financial statements.
6. This RPG is applicable to all public sector entities other than Government Business Enterprises (GBEs).
7. Financial statement discussion and analysis should not be described as complying with this RPG unless it complies with all the requirements of this RPG.
8. In some jurisdictions, preparation and presentation of financial statement discussion and analysis is a legislative or regulatory requirement, or required by other externally imposed regulations. Entities are encouraged to disclose information about the impact of such requirements on compliance with this RPG.

Definition

9. The following term is used in this RPG with the meaning specified:

Financial statement discussion and analysis is an explanation of the significant items, transactions and events presented in an entity’s financial statements and the factors that influenced them.

Terms used in this RPG with the meanings specified in International Public Sector Accounting Standards (IPSASs) are set out in Appendix A.

Identification of Financial Statement Discussion and Analysis

10. Financial statement discussion and analysis should be clearly identified, and distinguished from the financial statements and from other information.
11. Separate identification of financial statement discussion and analysis enables users to distinguish:
 - (a) Financial statements prepared and presented under the accrual basis of accounting in accordance with IPSASs;
 - (b) Financial statement discussion and analysis prepared in accordance with this RPG; and
 - (c) Other information presented in an annual report or other document that may be useful to users but is not the subject of requirements in IPSASs or recommendations in RPGs (but could be the subject of guidance in other RPGs).
12. Financial statement discussion and analysis should identify the financial statements to which it relates.

Presenting Financial Statement Discussion and Analysis

13. Financial statement discussion and analysis provides information useful to users for accountability and decision-making purposes by enabling users to gain an insight into the operations of the entity from the perspective of the entity itself. It also provides the opportunity to reflect the entity's interpretation of significant items, transactions and events affecting the financial position, financial performance and cash flows of the entity. Therefore, financial statement discussion and analysis complements the information in the financial statements.
14. Information in financial statement discussion and analysis should meet the qualitative characteristics of financial reporting taking into account the constraints on information included in general purpose financial reports (GPFs)¹.

Content of Financial Statement Discussion and Analysis

15. The content of financial statement discussion and analysis should be consistent with the financial statements and the underlying items, transactions and events, as well as assumptions such as those relating to recognition and measurement.

¹ The qualitative characteristics of financial reporting are relevance, faithful representation, understandability, timeliness, comparability and verifiability. The constraints on information are materiality, cost-benefit and the balance between the qualitative characteristics. See Chapter 3 of the *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* for further details.

16. Financial statement discussion and analysis should include the following, without merely replicating information in the financial statements:
 - (a) An overview of the entity's operations and the environment in which it operates;
 - (b) Information about the entity's objectives and strategies;
 - (c) An analysis of the entity's financial statements including significant changes and trends in an entity's financial position, financial performance and cash flows; and
 - (d) A description of the entity's principal risks and uncertainties that affect its financial position, financial performance and cash flows, an explanation of changes in those risks and uncertainties since the last reporting date and its strategies for bearing or mitigating those risks and uncertainties.
17. The form and specific content of an entity's financial statement discussion and analysis should reflect the nature of the entity and the regulatory environment in which it operates.
18. Where financial statement discussion and analysis includes information that is also in the financial statements, it should not merely repeat what is in the financial statements, but should analyze and explain how items, transactions and events affect the entity's financial position, financial performance and cash flows. Financial statement discussion and analysis should include cross-references to the financial statements where appropriate to avoid duplication of information.

Overview of the Entity's Operations and Environment

19. An overview of the entity helps users to understand the entity's operations and how the environment in which it operates affects its financial statements. This information assists users' understanding of an entity's financial statements. Information provided about an entity's operations in financial statement discussion and analysis may include current information, and changes from the prior period, relating to:
 - (a) The entity's mission and vision;
 - (b) The entity's governance (e.g., legislative or regulatory structure, management structure);
 - (c) The entity's relationships with other entities, with a focus on relationships that could significantly affect the entity's financial position, financial performance and cash flows (e.g., funding arrangements);

- (d) External trends, events and developments in the legal, regulatory, social, political and macro-economic environment specific to the entity, which have or may have a significant impact on the entity's financial position, financial performance and cash flows (e.g., the impact of events in international markets on employment, the tax base, or interest rates); and
- (e) The entity's main operations, including service delivery methods (e.g., outsourcing, service concession arrangements) and significant changes in them.

Information about the Entity's Objectives and Strategies

- 20. Financial statement discussion and analysis should discuss the entity's objectives and strategies relating to its financial position, financial performance and cash flows in a way that enables users of the financial statements to understand the entity's priorities and to identify the resources that must be managed to achieve these objectives and strategies. For example, such objectives and strategies could include managing surplus/deficit, and managing the levels of debt and reserves. Financial statement discussion and analysis should explain how achievement of the entity's objectives would be measured and over what time period progress would be measured.
- 21. Financial statement discussion and analysis should discuss significant changes in an entity's objectives and strategies from the previous period or periods.

Analysis of the Entity's Financial Statements

- 22. Financial statement discussion and analysis should include an analysis of significant changes and trends in an entity's financial position, financial performance and cash flows. An analysis of trends includes those financial statement items that are important and significant to gaining a better understanding of an entity's financial position, financial performance and cash flows and changes in financial position, financial performance and cash flows over a period of time.
- 23. Financial statement discussion and analysis should describe the significant items, transactions and events that have affected the financial position, financial performance and cash flows, without simply reiterating the information presented in the financial statements. Judgment is required in identifying the significant items, transactions and events.
- 24. If information from the financial statements has been adjusted for inclusion in financial statement discussion and analysis, that fact should be disclosed along with the nature of and reasons for the adjustments. When financial performance measures are derived from the financial statements, those measures should be reconciled to measures presented in the financial statements that have been prepared in accordance with IPSASs.

25. Comparative information should be disclosed for amounts presented in financial statement discussion and analysis when it is relevant to an understanding of the current period's financial statement discussion and analysis.
26. When an entity is required or elects to make its approved budget(s) publicly available, IPSAS 24, *Presentation of Budget Information in Financial Statements* requires a comparison of budget and actual amounts in the financial statements. IPSAS 24 also requires an explanation of material differences between the budgeted and actual amounts and permits an entity to disclose this information either in the notes to the financial statements or in other public reports. When an entity elects to include this information in its financial statement discussion and analysis, it should apply the guidance in IPSAS 24 to these disclosures.

Risks and Uncertainties

27. Financial statement discussion and analysis should discuss the entity's principal risks and uncertainties that affect its financial position, financial performance and cash flows and include an explanation of how this relates to the objectives and strategies of the entity. This information would help users to evaluate the impact of those risks in the current period (e.g., contingent liabilities disclosed in the financial statements or the use of foreign currency hedges to mitigate risk) as well as expected outcomes.
28. The principal risks and uncertainties can be external or internal risks; any description of these risks and uncertainties should cover exposures to both negative consequences and potential opportunities.
29. A discussion of how the entity manages its risks and uncertainties helps users obtain a faithful representation of the entity's exposure to risks that directly affect financial statement items, which allows them to evaluate the entity's financial position, financial performance and cash flows. Such disclosure may include the entity's decision to "self-insure" in respect of some risks, or to mitigate risk by transferring or sharing it through insurance.
30. A discussion of these risks and uncertainties would provide relevant information to users about exposure or vulnerability to concentrations of risks such as significant loans to particular regions or industries, or dependence on a particular source of revenue.
31. Risks and uncertainties that affect the financial position, financial performance and cash flows may have a pervasive effect on the financial statements. Therefore, information relating to these risks and uncertainties may be reported separately, or in relevant sections throughout financial statement discussion and analysis.

Terms in this RPG Defined in IPSASs

Term	Definition
Approved budget	The expenditure authority derived from laws, appropriation bills, government ordinances, and other decisions related to the anticipated revenue or receipts for the budgetary period.
Government Business Enterprise	An entity that has all the following characteristics: <div><div>(a)</div>Is an entity with the power to contract in its own name; <div>(b)</div>Has been assigned the financial and operational authority to carry on a business; <div>(c)</div>Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery; <div>(d)</div>Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm’s length); and <div>(e)</div>Is controlled by a public sector entity.</div>

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, RPG 2.

Background

- BC1. The IPSASB approved a project in March 2008 to address “narrative reporting”. In developing this RPG, the IPSASB clarified that the scope of the project was to address only those reports that provide discussion and analysis specifically relating to an entity’s general purpose financial statements (“financial statements”) as set out in IPSAS 1, *Presentation of Financial Statements* and not broader types of reports that may be considered general purpose financial reports as envisaged in the IPSASB’s *Conceptual Framework for General Purpose Financial Reporting by Public Sector Entities* (the *Conceptual Framework*). The IPSASB considers that it is important to provide narrative information related directly to the financial statements since this provides useful information for accountability and decision-making by users of financial statements.
- BC2. In undertaking this project, the IPSASB considered, under its *Process for Reviewing and Modifying IASB Documents*, whether to develop guidance that was converged with *Management Commentary*, an IFRS Practice Statement. The IPSASB did not consider this approach to be appropriate because the users identified in the Practice Statement are investors whereas Chapter 2 of the *Conceptual Framework* identifies different users, which results in different information needs related to the financial statements. On this basis the IPSASB decided it was important to develop guidance on financial statement discussion and analysis specific to the public sector. Financial statement discussion and analysis assists users of public sector entities’ financial statements by complementing and supplementing the financial statement explanations with insights and perspectives.
- BC3. Financial statement discussion and analysis is intended to address similar matters to reports that may be termed “management discussion and analysis” and “management commentary” in various jurisdictions. However, the IPSASB did not consider those terms to accurately describe the nature of the report in relation to the financial statements. The IPSASB decided it was important to link financial statement discussion and analysis to the financial statements because financial statement discussion and analysis is intended to explain the financial statements, and not to stand alone. The IPSASB considers the term “financial statement discussion and analysis” clearly defines the scope of applicability of this RPG and its close linkage to the financial statements.

Exposure Draft 47, *Financial Statement Discussion and Analysis*

- BC4. The IPSASB developed Exposure Draft (ED) 47, *Financial Statement Discussion and Analysis* which was issued in March 2012. This ED proposed

that entities that prepare and present their financial statements in accordance with IPSASs should be required to prepare financial statement discussion and analysis. This meant that financial statement discussion and analysis would have the same level of authority as accrual-based IPSASs even though it related to a GPFR.

- BC5. In developing the ED the IPSASB considered that financial statement discussion and analysis provides additional information necessary to meet the objectives of financial statements. Furthermore, the IPSASB considered that the benefits of providing financial statement discussion and analysis would outweigh the costs of preparing it, as the information is used in the preparation of the financial statements, and tailored to the specific circumstances of the entity. The IPSASB therefore proposed that financial statement discussion and analysis should be prepared by all entities that prepare their financial statements in accordance with IPSASs.
- BC6. Some respondents to the ED raised the concern that entities might not be able to assert compliance with IPSASs applicable to the financial statements if they did not follow the proposed requirements in the ED (if issued as an IPSAS). In particular, respondents were concerned that financial statement discussion and analysis might still be considered to be a part of the IPSAS reporting framework even though the ED explicitly stated that financial statement discussion and analysis is not a component of the financial statements. Some of these respondents suggested that this would not be an issue if the ED was developed into non-authoritative guidance, e.g., a Recommended Practice Guideline (RPG).
- BC7. The IPSASB considered whether the ED should be developed as an IPSAS or an RPG. The IPSASB considered this issue in the context of whether or not authoritative pronouncements could be developed for GPFRs, an issue on which members had varying views. The IPSASB noted that the scope of its *Conceptual Framework* is not limited to general purpose financial statements.
- BC8. Respondents to the ED were split on this issue with a slight majority favoring the material not becoming an IPSAS. Of those not in favor of issuing an IPSAS, the majority of respondents expressed a clear view that it should be issued as guidance similar to the proposed *RPG Reporting on the Long-Term Sustainability of an Entity's Finances*.
- BC9. As a well-established area of GPFRs, an authoritative pronouncement on financial statement discussion and analysis would help entities meet the accountability objective of financial reporting since it would enable users to gain an insight into the operations of the entity from the perspective of the entity itself. Financial statement discussion and analysis is an explanation of the financial statements but is not part of the financial statements and therefore it is not required for the fair presentation of the financial statements.

- BC10. On balance the IPSASB decided that the ED should be developed into an RPG. The IPSASB considers that this RPG provides useful guidance for entities and its flexible application could benefit entities in jurisdictions that have local requirements or regulations. It will also promote comparability across entities that present financial statement discussion and analysis. Furthermore, the IPSASB considers that the RPG might encourage entities that are not accustomed to presenting financial statement discussion and analysis to provide users with this information.
- BC11. Because financial statement discussion and analysis contributes to meeting the accountability objective of financial reporting, the IPSASB decided that it should consider the authority of this pronouncement on financial statement discussion and analysis in the future.

Forward-Looking Information

- BC12. The IPSASB considered whether it should recommend that an entity disclose forward-looking information, such as forecasts. The IPSASB acknowledged concerns that in some jurisdictions providing forward-looking information might be seen as signaling political intent or committing a public sector entity to certain future actions. In addition, whether forward-looking information can be included in financial statement discussion and analysis will vary depending upon the regulatory and budgetary reporting environment in which the entity operates. Some members expressed the opinion that not including forward-looking information could have an impact on the ability of financial discussion and analysis to support decision-making of users and therefore its inclusion should be recommended. However, on balance the IPSASB decided not to recommend that an entity disclose forward-looking information, though such information may be provided if an entity so chooses.

Implementation Guidance and Illustrative Examples

- BC13. ED 47 included Implementation Guidance on qualitative characteristics, and illustrative examples of information about the entity's financial statements and variances and trends. The IPSASB decided to delete the implementation guidance and illustrative examples on the basis that entities preparing financial statement discussion and analysis should focus on the guidance in the RPG. Moreover, the IPSASB observed that best-practice examples are available from other sources.

GLOSSARY OF DEFINED TERMS

This Glossary contains all terms defined in the 32 accrual basis International Public Sector Accounting Standards (IPSASs) approved up to January 15, 2014. A list of these IPSASs is located on the inside back cover of the Glossary. This Glossary does not include terms defined in the Cash Basis IPSAS, *Financial Reporting under the Cash Basis of Accounting*. Users should refer to that Cash Basis IPSAS for these terms.

Definitions

References to accrual basis IPSASs are by Standard number and paragraph number. For example, 1.7 refers users to IPSAS 1, *Presentation of Financial Statements*, paragraph 7. References set out in brackets indicate a minor variation in wording.

Term	Definition	Location
accounting basis	The accrual or cash basis of accounting as defined in the accrual basis IPSASs and the Cash Basis IPSAS.	24.7
accounting policies	The specific principles, bases, conventions, rules, and practices applied by an entity in preparing and presenting financial statements.	3.7
accrual basis	A basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue, and expenses.	1.7
active market	A market in which all the following conditions exist: <ul style="list-style-type: none"> (a) The items traded within the market are homogeneous; (b) Willing buyers and sellers can normally be found at any time; and (c) Prices are available to the public. 	21.14
actuarial gains and losses	Comprise: <ul style="list-style-type: none"> (a) Experience adjustments (the effects of differences between the previous actuarial assumptions and what has 	25.10

Term	Definition	Location
	actually occurred); and	
	(b) The effects of changes in actuarial assumptions.	
agricultural activity	The management by an entity of the biological transformation and harvest of biological assets for: <ul style="list-style-type: none"> • Sale; • Distribution at no charge or for a nominal charge; or • Conversion into agricultural produce or into additional biological assets for sale or for distribution at no charge or for a nominal charge. 	27.9
agricultural produce	The harvested product of the entity's biological assets.	27.9
amortization	The systematic allocation of the depreciable amount of an intangible asset over its useful life.	31.16
amortized cost of a financial asset or financial liability	The amount at which the financial asset or financial liability is measured at initial recognition minus principal repayments, plus or minus the cumulative amortization using the effective interest method of any difference between that initial amount and the maturity amount, and minus any reduction (directly or through the use of an allowance account) for impairment or uncollectibility.	29.10
annual budget	An approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.	24.7
appropriation	An authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority	24.7
approved budget	The expenditure authority derived from laws, appropriation bills, government ordinances, and other decisions related to the anticipated revenue or receipts for the budgetary period.	24.7
assets	Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are	1.7

Term	Definition	Location
	expected to flow to the entity.	
assets held by a long-term employee benefit fund	Assets (other than non-transferable financial instruments issued by the reporting entity) that: <ul style="list-style-type: none"> (a) Are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and (b) Are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either: <ul style="list-style-type: none"> (i) The remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or (ii) The assets are returned to the reporting entity to reimburse it for employee benefits already paid. 	25.10
associate	An entity, including an unincorporated entity such as a partnership, over which the investor has significant influence, and that is neither a controlled entity nor an interest in a joint venture.	7.7
available-for-sale financial assets	Those non-derivative financial assets that are designated as available for sale or are not classified as (a) loans and receivables, (b) held-to-maturity investments or (c) financial assets at fair value through surplus or deficit.	29.10
binding arrangement (for a service concession arrangement)	Describes contracts and other arrangements that confer similar rights and obligations on the parties to it as if they were in the form of a contract.	32.8
biological asset	A living animal or plant.	27.9
biological transformation	Comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset.	27.9

Term	Definition	Location
borrowing costs	Interest and other expenses incurred by an entity in connection with the borrowing of funds.	5.5
budgetary basis	The accrual, cash, or other basis of accounting adopted in the budget that has been approved by the legislative body.	24.7
carrying amount (of an intangible asset)	The amount at which an asset is recognized after deducting any accumulated amortization and accumulated impairment losses.	31.16
carrying amount (of investment property)	The amount at which an asset is recognized in the statement of financial position.	16.7
carrying amount (of property, plant, and equipment)	The amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.	17.13
carrying amount of a liability	The amount at which a liability is recognized in the statement of financial position.	10.7
carrying amount of an asset	The amount at which an asset is recognized in the statement of financial position, after deducting any accumulated depreciation and accumulated impairment losses thereon.	10.7
cash	Comprises cash on hand and demand deposits.	2.8
cash equivalents	Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.	2.8
cash flows	Inflows and outflows of cash and cash equivalents.	2.8
cash-generating assets	Assets held with the primary objective of generating a commercial return.	21.14
cash-generating unit	The smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.	26.13
change in accounting estimate	An adjustment of the carrying amount of an asset or a liability, or the amount of the periodic consumption of an asset, that results	3.7

Term	Definition	Location
	from the assessment of the present status of, and expected future benefits and obligations associated with, assets and liabilities. Changes in accounting estimates result from new information or new developments and, accordingly, are not correction of errors.	
class of property, plant, and equipment	A grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements.	17.13
close members of the family of an individual	Close relatives of the individual or members of the individual's immediate family who can be expected to influence, or be influenced by, that individual in their dealings with the entity.	20.4
closing rate	The spot exchange rate at the reporting date.	4.10
commencement of the lease term	The date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e., the recognition of the assets, liabilities, revenue, or expenses resulting from the lease, as appropriate).	13.8
comparable basis	The actual amounts presented on the same accounting basis, same classification basis, for the same entities, and for the same period as the approved budget.	24.7
composite social security programs	Programs established by legislation, and (a) Operate as multi-employer plans to provide post-employment benefits; as well as to (b) Provide benefits that are not consideration in exchange for service rendered by employees.	25.10
conditions on transferred assets	Stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.	23.7
consolidated financial	The financial statements of an economic entity presented as those of a single entity.	6.7

Term	Definition	Location
statements		
construction contract	A contract, or a similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology, and function or their ultimate purpose or use.	11.4
constructive obligation	An obligation that derives from an entity's actions where: <ul style="list-style-type: none"> (a) By an established pattern of past practice, published policies, or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and (b) As a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities. 	19.18
contingent asset	A possible asset that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.	19.18
contingent liability	<ul style="list-style-type: none"> (a) A possible obligation that arises from past events, and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) A present obligation that arises from past events, but is not recognized because: <ul style="list-style-type: none"> (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or (ii) The amount of the obligation cannot be measured with sufficient reliability. 	19.18
contingent rent	That portion of the lease payments that is not	13.8

Term	Definition	Location
	fixed in amount, but is based on the future amount of a factor that changes other than with the passage of time (e.g., percentage of future sales, amount of future use, future price indices, future market rates of interest).	
contractor	An entity that performs construction work pursuant to a construction contract.	11.4
contributions from owners	<p>Future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which:</p> <p>(a) Conveys entitlement both to (i) distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to (ii) distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or</p> <p>(b) Can be sold, exchanged, transferred, or redeemed.</p>	1.7
control	The power to govern the financial and operating policies of another entity so as to benefit from its activities.	2.8
control of an asset	Arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives, and can exclude or otherwise regulate the access of others to that benefit.	23.7
controlled entity	An entity, including an unincorporated entity such as a partnership, which is under the control of another entity (known as the controlling entity).	6.7
controlling entity	An entity that has one or more controlled entities.	6.7
cost	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.	16.7

Term	Definition	Location
cost method	A method of accounting for an investment, whereby the investment is recognized at cost. The investor recognizes revenue from the investment only to the extent that the investor is entitled to receive distributions from accumulated surpluses of the investee arising after the date of acquisition. Entitlements due or received in excess of such surpluses are regarded as a recovery of investment, and are recognized as a reduction of the cost of the investment.	6.7
cost plus or cost-based contract	A construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially based contract, an additional percentage of these costs or a fixed fee, if any.	11.4
costs of disposal	Incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.	21.14
costs to sell	The incremental costs directly attributable to the disposal of an asset, excluding finance costs and income taxes. Disposal may occur through sale or through distribution at no charge or for a nominal charge.	27.9
credit risk	The risk that one party to a financial instrument will cause a financial loss for the other party by failing to discharge an obligation.	30.8
currency risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in foreign exchange rates.	30.8
current replacement cost	The cost the entity would incur to acquire the asset on the reporting date.	12.9
current service cost	The increase in the present value of the defined benefit obligation resulting from employee service in the current period.	25.10
defined benefit plans	Post-employment benefit plans other than defined contribution plans.	25.10
defined contribution plans	Post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund), and will have no legal	25.10

Term	Definition	Location
	or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.	
depreciable amount	The cost of an asset, or other amount substituted for cost, less its residual value.	17.13
depreciation	The systematic allocation of the depreciable amount of an asset over its useful life.	17.13
derecognition	The removal of a previously recognized financial asset or financial liability from an entity's statement of financial position.	29.10
derivative	<p>A financial instrument or other contract within the scope of [IPSAS 29] (see paragraphs 2–6) with all three of the following characteristics:</p> <ul style="list-style-type: none"> (a) Its value changes in response to the change in a specified interest rate, financial instrument price, commodity price, foreign exchange rate, index of prices or rates, credit rating or credit index, or other variable, provided in the case of a non-financial variable that the variable is not specific to a party to the contract (sometimes called the “underlying”); (b) It requires no initial net investment or an initial net investment that is smaller than would be required for other types of contracts that would be expected to have a similar response to changes in market factors; and (c) It is settled at a future date. 	29.10
development	The application of research findings or other knowledge to a plan or design for the production of new or substantially improved materials, devices, products, processes, systems or services before the start of commercial production or use.	31.16
distributions to owners	Future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as	1.7

Term	Definition	Location
	a return of investment.	
economic entity	A group of entities comprising a controlling entity and one or more controlled entities.	1.7
economic life	Either: <ul style="list-style-type: none"> (a) The period over which an asset is expected to yield economic benefits or service potential to one or more users; or (b) The number of production or similar units expected to be obtained from the asset by one or more users. 	13.8
effective interest method	A method of calculating the amortized cost of a financial asset or a financial liability (or group of financial assets or financial liabilities) and of allocating the interest revenue or interest expense over the relevant period. The effective interest rate is the rate that exactly discounts estimated future cash payments or receipts through the expected life of the financial instrument or, when appropriate, a shorter period to the net carrying amount of the financial asset or financial liability. When calculating the effective interest rate, an entity shall estimate cash flows considering all contractual terms of the financial instrument (e.g., prepayment, call and similar options) but shall not consider future credit losses. The calculation includes all fees and points paid or received between parties to the contract that are an integral part of the effective interest rate (see IPSAS 9, <i>Revenue from Exchange Transactions</i>), transaction costs, and all other premiums or discounts. There is a presumption that the cash flows and the expected life of a group of similar financial instruments can be estimated reliably. However, in those rare cases when it is not possible to estimate reliably the cash flows or the expected life of a financial instrument (or group of financial instruments), the entity shall use the contractual cash flows over the full contractual term of the financial instrument (or group of financial instruments).	29.10

Term	Definition	Location
employee benefits	All forms of consideration given by an entity in exchange for service rendered by employees.	25.10
entity-specific value	The present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.	17.13
equity instrument Applicable for periods beginning on or after January 1, 2013.	Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.	28.9
equity method (relating to interests in joint ventures)	A method of accounting whereby an interest in a jointly controlled entity is initially recorded at cost, and adjusted thereafter for the post-acquisition change in the venturer's share of net assets/equity of the jointly controlled entity. The surplus or deficit of the venturer includes the venturer's share of the surplus or deficit of the jointly controlled entity.	8.6
equity method (relating to investments in associates)	A method of accounting whereby the investment is initially recognized at cost, and adjusted thereafter for the post-acquisition change in the investor's share of net assets/equity of the investee. The surplus or deficit of the investor includes the investor's share of the surplus or deficit of the investee.	7.7
events after the reporting date	Those events, both favorable and unfavorable, that occur between the reporting date and the date when the financial statements are authorized for issue. Two types of events can be identified: <ul style="list-style-type: none"> (a) Those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and (b) Those that are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date). 	14.5

Term	Definition	Location
exchange difference	The difference resulting from translating a given number of units of one currency into another currency at different exchange rates.	4.10
exchange rate	The ratio of exchange for two currencies.	4.10
exchange transactions	Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.	9.11
executory contracts	Contracts under which neither party has performed any of its obligations, or both parties have partially performed their obligations to an equal extent.	19.18
expenses	Decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.	1.7
expenses paid through the tax system	Amounts that are available to beneficiaries regardless of whether or not they pay taxes.	23.7
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm's length transaction.	9.11
fair value less costs to sell	The amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.	21.14
final budget	The original budget, adjusted for all reserves, carry-over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative or similar authority changes applicable to the budget period	24.7
finance lease	A lease that transfers substantially all the risks and rewards incidental to ownership of an asset. Title may or may not eventually be transferred.	13.8

Term	Definition	Location
financial asset	Any asset that is:	28.9
Applicable for periods beginning on or after January 1, 2013.	<ul style="list-style-type: none"> (a) Cash; (b) An equity instrument of another entity; (c) A contractual right: <ul style="list-style-type: none"> (i) To receive cash or another financial asset from another entity; or (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially favorable to the entity; or (d) A contract that will or may be settled in the entity's own equity instruments and is: <ul style="list-style-type: none"> (i) A non-derivative for which the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or (ii) A derivative that will or may be settled other than by the exchange of a fixed amount of cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments. 	

Term	Definition	Location
financial asset or financial liability at fair value through surplus or deficit	<p>A financial asset or financial liability that meets either of the following conditions.</p> <p>(a) It is classified as held for trading. A financial asset or financial liability is classified as held for trading if:</p> <ul style="list-style-type: none"> (i) It is acquired or incurred principally for the purpose of selling or repurchasing it in the near term; (ii) On initial recognition it is part of a portfolio of identified financial instruments that are managed together and for which there is evidence of a recent actual pattern of short-term profit-taking; or (iii) It is a derivative (except for a derivative that is a financial guarantee contract or a designated and effective hedging instrument). <p>(b) Upon initial recognition it is designated by the entity as at fair value through surplus or deficit. An entity may use this designation only when permitted by paragraph 13 or when doing so results in more relevant information, because either:</p> <ul style="list-style-type: none"> (i) It eliminates or significantly reduces a measurement or recognition inconsistency (sometimes referred to as “an accounting mismatch”) that would otherwise arise from measuring assets or liabilities or recognizing the gains and losses on them on different bases; or (ii) A group of financial assets, financial liabilities or both is managed and its performance is evaluated on a fair value basis, in accordance with a documented risk management or 	29.10

Term	Definition	Location
	investment strategy, and information about the group is provided internally on that basis to the entity's key management personnel (as defined in IPSAS 20, <i>Related Party Disclosures</i>), for example the entity's governing body and chief executive officer.	
financial guarantee contract	A contract that requires the issuer to make specified payments to reimburse the holder for a loss it incurs because a specified debtor fails to make payment when due in accordance with the original or modified terms of a debt instrument.	29.10
financial instrument Applicable for periods beginning on or after January 1, 2013.	Any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity.	28.9
financial liability Applicable for periods beginning on or after January 1, 2013.	Any liability that is: <ul style="list-style-type: none"> (a) A contractual obligation: <ul style="list-style-type: none"> (i) To deliver cash or another financial asset to another entity; or (ii) To exchange financial assets or financial liabilities with another entity under conditions that are potentially unfavorable to the entity; or (b) A contract that will or may be settled in the entity's own equity instruments and is: <ul style="list-style-type: none"> (i) A non-derivative for which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or (ii) A derivative that will or may be settled other than by the exchange of a fixed amount of 	28.9

Term	Definition	Location
	<p>cash or another financial asset for a fixed number of the entity's own equity instruments. For this purpose the entity's own equity instruments do not include puttable financial instruments classified as equity instruments in accordance with paragraphs 15 and 16, instruments that impose on the entity an obligation to deliver to another party a pro rata share of the net assets of the entity only on liquidation and are classified as equity instruments in accordance with paragraphs 17 and 18, or instruments that are contracts for the future receipt or delivery of the entity's own equity instruments.</p> <p>As an exception, an instrument that meets the definition of a financial liability is classified as an equity instrument if it has all the features and meets the conditions in paragraph 15 and 16 or paragraphs 17 and 18.</p>	
financing activities	Activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.	2.8
fines	Economic benefits or service potential received or receivable by public sector entities, as determined by a court or other law enforcement body, as a consequence of the breach of laws or regulations.	23.7
firm commitment	A binding agreement for the exchange of a specified quantity of resources at a specified price on a specified future date or dates.	29.10
fixed price contract	A construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.	11.4
forecast transaction	An uncommitted but anticipated future transaction.	29.10

Term	Definition	Location
foreign currency	A currency other than the functional currency of the entity.	4.10
foreign operation	An entity that is a controlled entity, associate, joint venture, or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.	4.10
functional currency	The currency of the primary economic environment in which the entity operates.	4.10
general government sector	Comprises all organizational entities of the general government as defined in statistical bases of financial reporting	22.15
Government Business Enterprise	An entity that has all the following characteristics: <ul style="list-style-type: none"> (a) Is an entity with the power to contract in its own name; (b) Has been assigned the financial and operational authority to carry on a business; (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery; (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and (e) Is controlled by a public sector entity. 	1.7
grantor (in a service concession arrangement)	Is the entity that grants the right to use the service concession asset to the operator.	32.8
gross investment in the lease	The aggregate of: <ul style="list-style-type: none"> (a) The minimum lease payments receivable by the lessor under a finance lease; and (b) Any unguaranteed residual value accruing to the lessor. 	13.8
group of biological assets	An aggregation of similar living animals or plants.	27.9

Term	Definition	Location
guaranteed residual value	<p>(a) For a lessee, that part of the residual value that is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and</p> <p>(b) For a lessor, that part of the residual value that is guaranteed by the lessee, or by a third party unrelated to the lessor, that is financially capable of discharging the obligations under the guarantee.</p>	13.8
harvest	The detachment of produce from a biological asset or the cessation of a biological asset's life processes.	27.9
hedged item	An asset, liability, firm commitment, highly probable forecast transaction or net investment in a foreign operation that (a) exposes the entity to risk of changes in fair value or future cash flows and (b) is designated as being hedged ([IPSAS 29] paragraphs 87–94 and Appendix A paragraphs AG131–AG141 elaborate on the definition of hedged items).	29.10
hedge effectiveness	The degree to which changes in the fair value or cash flows of the hedged item that are attributable to a hedged risk are offset by changes in the fair value or cash flows of the hedging instrument (see [IPSAS 29] Appendix A paragraphs AG145–AG156).	29.10
hedging instrument	A designated derivative or (for a hedge of the risk of changes in foreign currency exchange rates only) a designated non-derivative financial asset or non-derivative financial liability whose fair value or cash flows are expected to offset changes in the fair value or cash flows of a designated hedged item ([IPSAS 29] paragraphs 81–86 and Appendix A paragraphs AG127–AG130 elaborate on the definition of a hedging instrument).	29.10
held-to-maturity investments	Non-derivative financial assets with fixed or determinable payments and fixed maturity	29.10

Term	Definition	Location
	<p>that an entity has the positive intention and ability to hold to maturity (see [IPSAS 29] Appendix A paragraphs AG29–AG38) other than:</p> <ul style="list-style-type: none"> (a) Those that the entity upon initial recognition designates as at fair value through surplus or deficit; (b) Those that the entity designates as available for sale; and (c) Those that meet the definition of loans and receivables. <p>An entity shall not classify any financial assets as held to maturity if the entity has, during the current financial year or during the two preceding financial years, sold or reclassified more than an insignificant amount of held-to-maturity investments before maturity (more than insignificant in relation to the total amount of held-to-maturity investments) other than sales or reclassifications that:</p> <ul style="list-style-type: none"> (a) Are so close to maturity or the financial asset's call date (e.g., less than three months before maturity) that changes in the market rate of interest would not have a significant effect on the financial asset's fair value; (b) Occur after the entity has collected substantially all of the financial asset's original principal through scheduled payments or prepayments; or (c) Are attributable to an isolated event that is beyond the entity's control, is non-recurring and could not have been reasonably anticipated by the entity. 	
impairment	A loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.	21.14
impairment loss of a cash-generating	The amount by which the carrying amount of an asset exceeds its recoverable amount.	17.13

Term	Definition	Location
asset		
impairment loss of a non-cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable service amount.	17.13
impracticable (1)	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.	1.7
impracticable (2)	<p>Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:</p> <ul style="list-style-type: none"> (a) The effects of the retrospective application or retrospective restatement are not determinable; (b) The retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or (c) The retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that: <ul style="list-style-type: none"> (i) Provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognized, measured, or disclosed; and (ii) Would have been available when the financial statements for that prior period were authorized for issue; <p>from other information.</p>	3.7
inception of the lease	<p>The earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date:</p> <ul style="list-style-type: none"> (a) A lease is classified as either an 	13.8

Term	Definition	Location
	operating or a finance lease; and (b) In the case of a finance lease, the amounts to be recognized at the commencement of the lease term are determined.	
initial direct costs	Incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or trader lessors.	13.8
intangible asset	An identifiable non-monetary asset without physical substance.	31.16
interest cost	The increase during a period in the present value of a defined benefit obligation that arises because the benefits are one period closer to settlement.	25.10
interest rate implicit in the lease	The discount rate that, at the inception of the lease, causes the aggregate present value of: (a) The minimum lease payments; and (b) The unguaranteed residual value to be equal to the sum of (i) the fair value of the leased asset, and (ii) any initial direct costs of the lessor.	13.8
interest rate risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market interest rates.	30.8
inventories	Assets: (a) In the form of materials or supplies to be consumed in the production process; (b) In the form of materials or supplies to be consumed or distributed in the rendering of services; (c) Held for sale or distribution in the ordinary course of operations; or (d) In the process of production for sale or distribution.	12.9
investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents.	2.8
investment property	Property (land or a building – or part of a building – or both) held to earn rentals or for	16.7

Term	Definition	Location
	capital appreciation, or both, rather than for:	
	(a) Use in the production or supply of goods or services, or for administrative purposes; or	
	(b) Sale in the ordinary course of operations.	
joint control	The agreed sharing of control over an activity by a binding arrangement.	8.6
joint venture	A binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.	8.6
key management personnel	<p>(a) All directors or members of the governing body of the entity; and</p> <p>(b) Other persons having the authority and responsibility for planning, directing and controlling the activities of the reporting entity. Where they meet this requirement, key management personnel include:</p> <p>(i) Where there is a member of the governing body of a whole-of-government entity who has the authority and responsibility for planning, directing, and controlling the activities of the reporting entity, that member;</p> <p>(ii) Any key advisors of that member; and</p> <p>(iii) Unless already included in (a), the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity.</p>	20.4
lease	An agreement whereby the lessor conveys to the lessee, in return for a payment or series of payments, the right to use an asset for an agreed period of time.	13.8
lease term	The non-cancelable period for which the lessee has contracted to lease the asset, together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, when	13.8

Term	Definition	Location
	at the inception of the lease it is reasonably certain that the lessee will exercise the option.	
legal obligation	An obligation that derives from: (a) A contract (through its explicit or implicit terms); (b) Legislation; or (c) Other operation of law.	19.18
lessee's incremental borrowing rate of interest	The rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.	13.8
liabilities	Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.	1.7
liquidity risk	The risk that an entity will encounter difficulty in meeting obligations associated with financial liabilities that are settled by delivering cash or another financial asset.	30.8
loans and receivables	Non-derivative financial assets with fixed or determinable payments that are not quoted in an active market other than: (a) Those that the entity intends to sell immediately or in the near term, which shall be classified as held for trading, and those that the entity upon initial recognition designates as at fair value through surplus or deficit; (b) Those that the entity upon initial recognition designates as available for sale; or (c) Those for which the holder may not recover substantially all of its initial investment, other than because of credit deterioration, which shall be classified as available for sale.	29.10
loans payable	Financial liabilities, other than short-term	30.8

Term	Definition	Location
	trade payables on normal credit terms.	
market risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market risk comprises three types of risk: currency risk, interest rate risk, and other price risk.	30.8
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature and size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.	1.7
minimum lease payments	<p>The payments over the lease term that the lessee is, or can be, required to make, excluding contingent rent, costs for services and, where appropriate, taxes to be paid by and reimbursed to the lessor, together with:</p> <ul style="list-style-type: none"> (a) For a lessee, any amounts guaranteed by the lessee or by a party related to the lessee; or (b) For a lessor, any residual value guaranteed to the lessor by: <ul style="list-style-type: none"> (i) The lessee; (ii) A party related to the lessee; or (iii) An independent third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. <p>However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this</p>	13.8

Term	Definition	Location
	purchase option and the payment required to exercise it.	
minority interest	That portion of the surplus or deficit and net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly, through controlled entities, by the controlling entity.	6.7
monetary items	Units of currency held and assets and liabilities to be received or paid in a fixed or determinable number of units of currency.	4.10
multi-employer plans	Defined contribution plans (other than state plans and composite social security programs) or defined benefit plans (other than state plans) that: <ul style="list-style-type: none"> (a) Pool the assets contributed by various entities that are not under common control; and (b) Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned. 	25.10
multi-year budget	An approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.	24.7
net assets/equity	The residual interest in the assets of the entity after deducting all its liabilities.	1.7
net investment in a foreign operation	The amount of the reporting entity's interest in the net assets/equity of that operation.	4.10
net investment in the lease	The gross investment in the lease discounted at the interest rate implicit in the lease.	13.8
net realizable value	The estimated selling price in the ordinary course of operations, less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.	12.9
non-cancelable lease	A lease that is cancelable only: <ul style="list-style-type: none"> (a) Upon the occurrence of some remote contingency; 	13.8

Term	Definition	Location
	(b) With the permission of the lessor;	
	(c) If the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or	
	(d) Upon payment by the lessee of such an additional amount that, at inception of the lease, continuation of the lease is reasonably certain.	
non-cash-generating assets	Assets other than cash-generating assets.	21.14
non-exchange transactions	Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.	9.11
non-monetary items	Items that are not monetary items.	10.7
notes	Contain information in addition to that presented in the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement. Notes provide narrative descriptions or disaggregations of items disclosed in those statements and information about items that do not qualify for recognition in those statements.	1.7
obligating event	An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.	19.18
onerous contract	A contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.	19.18
operating activities	The activities of the entity that are not investing or financing activities.	2.8
operating lease	A lease other than a finance lease.	13.8
operator (in a service concession	Is the entity that uses the service concession asset to provide public services subject to the	32.8

Term	Definition	Location
arrangement)	grantor's control of the asset.	
original budget	The initial approved budget for the budget period.	24.7
other long-term employee benefits	Employee benefits (other than post-employment benefits and termination benefits) that are not due to be settled within twelve months after the end of the period in which the employees render the related service.	25.10
other price risk	The risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices (other than those arising from interest rate risk or currency risk), whether those changes are caused by factors specific to the individual financial instrument or its issuer, or factors affecting all similar financial instruments traded in the market.	30.8
oversight	The supervision of the activities of an entity, with the authority and responsibility to control, or exercise significant influence over, the financial and operating decisions of the entity.	20.4
owner-occupied property	Property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services, or for administrative purposes.	16.7
past due	A financial asset is past due when a counterparty has failed to make a payment when contractually due.	30.8
past service cost	The change in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (when benefits are introduced or changed so that the present value of the defined benefit obligation increases) or negative (when existing benefits are changed so that the present value of the defined benefit obligation decreases).	25.10

Term	Definition	Location
plan assets	Comprise: (a) Assets held by a long-term employee benefit fund; and (b) Qualifying insurance policies.	25.10
post-employment benefit plans	Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.	25.10
post-employment benefits	Employee benefits (other than termination benefits) which are payable after the completion of employment.	25.10
present value of a defined benefit obligation	The present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.	25.10
presentation currency	The currency in which the financial statements are presented.	4.10
prior period errors	Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) Was available when financial statements for those periods were authorized for issue; and (b) Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.	3.7
property, plant, and equipment	Tangible items that: (a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) Are expected to be used during more than one reporting period.	17.13
proportionate consolidation	A method of accounting whereby a venturer's share of each of the assets, liabilities, revenue	8.6

Term	Definition	Location
	and expenses of a jointly controlled entity is combined line by line with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.	
prospective application	Prospective application of a change in accounting policy and of recognizing the effect of a change in an accounting estimate, respectively, are: (a) Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and (b) Recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change	3.7
provision	A liability of uncertain timing or amount.	19.18
puttable instrument	A financial instrument that gives the holder the right to put the instrument back to the issuer for cash or another financial asset or is automatically put back to the issuer on the occurrence of an uncertain future event or the death or retirement of the instrument holder.	28.9
qualifying asset	An asset that necessarily takes a substantial period of time to get ready for its intended use or sale.	5.5
qualifying insurance policy	An insurance policy ¹ issued by an insurer that is not a related party (as defined in IPSAS 20) of the reporting entity, if the proceeds of the policy: (a) Can be used only to pay or fund employee benefits under a defined benefit plan; and (b) Are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:	25.10

¹ A qualifying insurance policy is not necessarily an insurance contract (see the relevant international or national standard dealing with insurance contracts).

Term	Definition	Location
	<ul style="list-style-type: none"> (i) The proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or (ii) The proceeds are returned to the reporting entity to reimburse it for employee benefits already paid. 	
recoverable amount (of an asset or a cash-generating unit)	The higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use.	26.13
recoverable amount (of property, plant, and equipment)	The higher of a cash-generating asset's fair value less costs to sell and its value in use.	17.13
recoverable service amount	The higher of a non-cash-generating asset's fair value less costs to sell and its value in use.	21.14
regular way purchase or sale	A purchase or sale of a financial asset under a contract whose terms require delivery of the asset within the time frame established generally by regulation or convention in the marketplace concerned.	29.10
related party	<p>Parties are considered to be related if one party has the ability to (a) control the other party, or (b) exercise significant influence over the other party in making financial and operating decisions, or if the related party entity and another entity are subject to common control. Related parties include:</p> <ul style="list-style-type: none"> (a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by, the reporting entity; (b) Associates (see IPSAS 7, <i>Investments in Associates</i>); (c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such 	20.4

Term	Definition	Location
	individual;	
	(d) Key management personnel, and close members of the family of key management personnel; and	
	(e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.	
related party transaction	A transfer of resources or obligations between related parties, regardless of whether a price is charged. Related party transactions exclude transactions with any other entity that is a related party solely because of its economic dependence on the reporting entity or the government of which it forms part.	20.4
remuneration of key management personnel	Any consideration or benefit derived directly or indirectly by key management personnel from the reporting entity for services provided in their capacity as members of the governing body, or otherwise as employees of the reporting entity.	20.4
reporting date	The date of the last day of the reporting period to which the financial statements relate.	2.8
research	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.	31.16
residual value (of property, plant, and equipment or an intangible asset)	The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.	17.13
restrictions on transferred assets	Stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified.	23.7
restructuring	A program that is planned and controlled by management, and materially changes either:	19.18

Term	Definition	Location
	(a) The scope of an entity's activities; or (b) The manner in which those activities are carried out.	
retrospective application	Applying a new accounting policy to transactions, other events, and conditions as if that policy had always been applied.	3.7
retrospective restatement	Correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.	3.7
return on plan assets	The interest, dividends or similar distributions and other revenue derived from the plan assets, together with realized and unrealized gains or losses on the plan assets, less any costs of administering the plan (other than those included in the actuarial assumptions used to measure the defined benefit obligation) and less any tax payable by the plan itself.	25.10
revenue	The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.	1.7
segment	A distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of (a) evaluating the entity's past performance in achieving its objectives and (b) making decisions about the future allocation of resources.	18.9
segment accounting policies	Accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity as well as those accounting policies that relate specifically to segment reporting.	18.27
segment assets	Are those operating assets that are employed by a segment in its operating activities, and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. If a segment's segment revenue includes	18.27

Term	Definition	Location
	<p>interest or dividend revenue, its segment assets include the related receivables, loans, investments, or other revenue-producing assets.</p> <p>Segment assets do not include income tax or income tax-equivalent assets that are recognized in accordance with accounting standards dealing with obligations to pay income tax or income tax equivalents.</p> <p>Segment assets include investments accounted for under the equity method only if the net surplus (deficit) from such investments is included in segment revenue. Segment assets include a joint venturer's share of the operating assets of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8, <i>Interests in Joint Ventures</i>.</p> <p>Segment assets are determined after deducting related allowances that are reported as direct offsets in the entity's statement of financial position.</p>	
segment expense	<p>An expense resulting from the operating activities of a segment that is directly attributable to the segment, and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to the provision of goods and services to external parties and expenses relating to transactions with other segments of the same entity. Segment expense does not include:</p> <ul style="list-style-type: none"> (a) Interest, including interest incurred on advances or loans from other segments, unless the segment's operations are primarily of a financial nature; (b) Losses on sales of investments or losses on extinguishment of debt, unless the segment's operations are primarily of a financial nature; (c) An entity's share of net deficit or losses of associates, joint ventures, or other investments accounted for under 	18.27

Term	Definition	Location
	<p>the equity method;</p> <p>(d) Income tax or income tax-equivalent expense that is recognized in accordance with accounting standards dealing with obligations to pay income tax or income tax equivalents; or</p> <p>(e) General administrative expenses, head office expenses, and other expenses that arise at the entity level and relate to the entity as a whole. However, costs are sometimes incurred at the entity level on behalf of a segment. Such costs are segment expenses if they relate to the segment's operating activities and they can be directly attributed or allocated to the segment on a reasonable basis.</p> <p>Segment expense includes a joint venturer's share of the expenses of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8.</p> <p>For a segment's operations that are primarily of a financial nature, interest revenue and interest expense may be reported as a single net amount for segment reporting purposes only if those items are netted in the consolidated or entity financial statements.</p>	
segment liabilities	<p>Those operating liabilities that result from the operating activities of a segment, and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis.</p> <p>If a segment's segment expense includes interest expense, its segment liabilities include the related interest-bearing liabilities.</p> <p>Segment liabilities include a joint venturer's share of the liabilities of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8.</p> <p>Segment liabilities do not include income tax or income tax equivalent liabilities that are recognized in accordance with accounting standards dealing with obligations to pay</p>	18.27

Term	Definition	Location
	income tax or income tax equivalents.	
segment revenue	<p>Is revenue reported in the entity's statement of financial performance that is directly attributable to a segment, and the relevant portion of entity revenue that can be allocated on a reasonable basis to a segment, whether from budget appropriations or similar, grants, transfers, fines, fees, or sales to external customers or from transactions with other segments of the same entity. Segment revenue does not include:</p> <ul style="list-style-type: none"> (a) Interest or dividend revenue, including interest earned on advances or loans to other segments, unless the segment's operations are primarily of a financial nature; or (b) Gains on sales of investments or gains on extinguishment of debt, unless the segment's operations are primarily of a financial nature. <p>Segment revenue includes an entity's share of net surplus (deficit) of associates, joint ventures, or other investments accounted for under the equity method, only if those items are included in consolidated or total entity revenue.</p> <p>Segment revenue includes a joint venturer's share of the revenue of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8.</p>	18.27
separate financial statements	Those financial statements presented by a controlling entity, an investor in an associate, or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.	6.7

Term	Definition	Location
service concession arrangement	Is a binding arrangement between a grantor and an operator in which: <ul style="list-style-type: none"> (a) The operator uses the service concession asset to provide a public service on behalf of the grantor for a specified period of time; and (b) The operator is compensated for its services over the period of the service concession arrangement. 	32.8
service concession asset	Is is an asset used to provide public services in a service concession arrangement that: <ul style="list-style-type: none"> (a) Is provided by the operator which: <ul style="list-style-type: none"> (i) The operator constructs, develops, or acquires from a third party; or (ii) Is an existing asset of the operator; or (a) Is provided by the grantor which: <ul style="list-style-type: none"> (i) Is an existing asset of the grantor; or (ii) Is an upgrade to an existing asset of the grantor. 	32.8
short-term employee benefits	Employee benefits (other than termination benefits) that are due to be settled within twelve months after the end of the period in which the employees render the related service.	25.10
significant influence (relating to interests in joint ventures)	The power to participate in the financial and operating policy decisions of an activity but is not control or joint control over those policies.	8.6
significant influence (relating to investments in associates)	The power to participate in the financial and operating policy decisions of the investee but is not control or joint control over those policies.	7.7
significant influence (relating to related party transactions)	The power to participate in the financial and operating policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for	20.4

Term	Definition	Location
	example, participation in (a) the policy making process, (b) material transactions between entities within an economic entity, (c) interchange of managerial personnel, or (d) dependence on technical information. Significant influence may be gained by an ownership interest, statute, or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in IPSAS 7.	
spot exchange rate	The exchange rate for immediate delivery.	4.10
state plans	Plans other than composite social security programs established by legislation that operate as if they are multi-employer plans for all entities in economic categories laid down in legislation.	25.10
stipulations on transferred assets	Terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.	23.7
tax expenditures	Preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.	23.7
taxable event	The event that the government, legislature, or other authority has determined will be subject to taxation.	23.7
taxes	Economic benefits or service potential compulsorily paid or payable to public sector entities, in accordance with laws and/or regulations, established to provide revenue to the government. Taxes do not include fines or other penalties imposed for breaches of the law.	23.7
termination benefits	Employee benefits payable as a result of either: <ul style="list-style-type: none"> (a) An entity's decision to terminate an employee's employment before the normal retirement date; or (b) An employee's decision to accept voluntary redundancy in exchange for those benefits. 	25.10

Term	Definition	Location
transaction costs	Incremental costs that are directly attributable to the acquisition, issue or disposal of a financial asset or financial liability (see [IPSAS 29] Appendix A paragraph AG26). An incremental cost is one that would not have been incurred if the entity had not acquired, issued or disposed of the financial instrument.	29.10
transfers	Inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.	23.7
unearned finance revenue	The difference between: (a) The gross investment in the lease; and (b) The net investment in the lease.	13.8
unguaranteed residual value	That portion of the residual value of the leased asset, the realization of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.	13.8
useful life (of a lease)	The estimated remaining period, from the commencement of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity.	13.8
useful life (of a non-cash-generating asset)	Either: (a) The period of time over which an asset is expected to be used by the entity; or (b) The number of production or similar units expected to be obtained from the asset by the entity.	21.14
useful life (of property, plant, and equipment or an intangible asset)	Either: (a) The period over which an asset is expected to be available for use by an entity; or (b) The number of production or similar units expected to be obtained from the asset by an entity.	17.13
value in use of a cash-generating asset	The present value of the estimated future cash flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life	26.13

GLOSSARY

Term	Definition	Location
value in use of a non-cash-generating asset	The present value of the asset's remaining service potential.	21.14
venturer	A party to a joint venture and has joint control over that joint venture.	8.6
vested employee benefits	Employee benefits that are not conditional on future employment.	25.10

Accrual IPSASs on Issue at January 15, 2014

Appendix A: List of IPSASs Effective Beginning on or After January 1, 2014

The 2014 Handbook includes all IPSASs. IPSASs show the latest amended text. Where an IPSAS includes paragraphs that are not yet effective these paragraphs are listed. Earlier application of the effective date of amended paragraphs is encouraged.

This Table is a list of those IPSASs that are applicable to annual financial statements covering periods beginning on or after January 1, 2014.

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
IPSAS 1— Presentation of Financial Statements (revised)	December 2006	January 1, 2008				
IPSAS 2—Cash Flow Statements	May 2000	July 1, 2001				
IPSAS 3— Accounting Policies, Changes in Accounting Estimates and Errors (revised)	December 2006	January 1, 2008				

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
IPSAS 4—The Effects of Changes in Foreign Exchange Rates (revised)	April 2008	January 1, 2010				
IPSAS 5— Borrowing Costs	May 2000	July 1, 2001				
IPSAS 6— Consolidated and Separate Financial Statements (revised)	December 2006	January 1, 2008				
IPSAS 7— Investments in Associates (revised)	December 2006	January 1, 2008				
IPSAS 8—Interests in Joint Ventures (revised)	December 2006	January 1, 2008				
IPSAS 9—Revenue from Exchange	July 2001	July 1, 2002				

ACCRUAL IPSASS ON ISSUE

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
Transactions						
IPSAS 10— Financial Reporting in Hyperinflationary Economies	July 2001	July 1, 2002				
IPSAS 11— Construction Contracts	July 2001	July 1, 2002				
IPSAS 12— Inventories (revised)	December 2006	January 1, 2008				
IPSAS 13—Leases (revised)	December 2006	January 1, 2008				
IPSAS 14—Events After the Reporting Date (revised)	December 2006	January 1, 2008				
IPSAS 16— Investment Property (revised)	December 2006	January 1, 2008				

ACCRUAL IPSASS ON ISSUE

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
IPSAS 17— Property, Plant, and Equipment (revised)	December 2006	January 1, 2008				
IPSAS 18— Segment Reporting	June 2002	July 1, 2003				
IPSAS 19— Provisions, Contingent Liabilities and Contingent Assets	October 2002	January 1, 2004				
IPSAS 20—Related Party Disclosures	October 2002	January 1, 2004				
IPSAS 21— Impairment of Non- Cash-Generating Assets	December 2004	January 1, 2006				
IPSAS 22— Disclosure of	December 2006	January 1, 2008				

ACCRUAL IPSASS ON ISSUE

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
Information About the General Government Sector						
IPSAS 23— Revenue from Non- Exchange Transactions (Taxes and Transfers)	December 2006	June 30, 2008				
IPSAS 24— Presentation of Budget Information in Financial Statements	December 2006	January 1, 2009				
IPSAS 25— Employee Benefits	February 2008	January 1, 2011				
IPSAS 26— Impairment of Cash- Generating Assets	February 2008	April 1, 2009				
IPSAS 27—	December 2009	April 1, 2011				

ACCRUAL IPSASS ON ISSUE

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
Agriculture						
IPSAS 28— Financial Instruments: Presentation	January 2010	January 1, 2013				
IPSAS 29— Financial Instruments: Recognition and Measurement	January 2010	January 1, 2013				
IPSAS 30— Financial Instruments: Disclosures	January 2010	January 1, 2013				
IPSAS 31— Intangible Assets	January 2010	April 1, 2011				
IPSAS 32—Service Concession	October 2011	January 1, 2014				

ACCRUAL IPSASS ON ISSUE

IPSAS	Issued	Original Effective Date On or After	Paragraphs Not Yet Effective			
Arrangements: Grantor						

Appendix B: List of IPSASs not yet Effective at January 1, 2014

This is a list of those IPSASs that are applicable to annual financial statements covering periods beginning on or after January 1, 2015. Currently there are no IPSAS issued which are not yet effective.

Table C: List of IPSASs no Longer Effective at January 1, 2014

This Table is a list of those IPSASs that are no longer applicable as they have been superceded and/or withdrawn.

IPSAS	Issued	Original Effective Date On or After	Reason and Date No Longer Effective
IPSAS 15— Financial Instruments: Disclosure and Presentation	December 2001	January 1, 2003	IPSAS 15 is superseded by IPSASs 28–30 from periods beginning on or after January 1, 2013.

THIS PAGE INTENTIONALLY LEFT BLANK

SUMMARY OF OTHER DOCUMENTS

The IPSASB has issued studies and other documents, as summarized below. To obtain copies of these documents, please visit the IFAC website at www.ifac.org or contact the IFAC offices.

Study 1

Financial Reporting by National Governments

Issued March 1991

The scope of the Study is to consider:

- Financial reporting by national governments and their major governmental units;
- Financial reports that provide information on government plans, performance and compliance with relevant authorities;
- Information needs of the principal users of government financial reports, with primary emphasis on the needs of external users; and
- The forms of reporting best suited to meeting those information needs.

This Study is of particular interest to senior financial officers in government, politicians, legislative auditors and others who use government financial reports because it addresses the fundamental underpinnings of governmental financial reporting.

Comparative summaries of users, user needs and objectives were prepared. They illustrate that there is concurrence on who users are, what their needs are and, accordingly, the objectives of financial reporting.

The Study develops a logical progression from users and user needs to the objectives of government financial reporting. It provides further context for the discussion of objectives by exploring the governmental environment and the limits of financial reporting.

The Study then discusses financial reporting. Rather than recommending a single, preferred financial reporting model, the Study describes the spectrum of possible bases of accounting and different reporting models (types of reports). It then illustrates their strengths and weaknesses in meeting the objectives of financial reporting. The Study demonstrates that in moving from single displays of cash receipts and disbursements to summary financial reports that account for total economic resources, more of the objectives of financial reporting are met. Since those objectives are derived from user needs, more complete and better information will better meet those needs.

The Study recognizes that financial reporting by national governments is influenced by government financial reporting policies and practices which are embedded in the provisions of legislation and legal prescription.

Study 2

Elements of the Financial Statements of National Governments

Issued July 1993

This Study considers the elements (types or classes of financial information) to be reported in financial statements prepared under the different bases of accounting that may be employed by national governments and their major units and the way in which those elements may be defined. It also considers the implications of reporting particular elements, or subsets thereof, for the messages communicated by financial statements and the achievement of the objectives identified in Study 1.

The Study aims to assist in developing the full potential of the accounting models currently employed in individual jurisdictions to communicate financial information to users. That is useful for accountability and decision making purposes.

This Study focuses on reporting the elements in the financial statements prepared for national governments. However, it is acknowledged that aspects of the delivery of goods and services and the achievement of government objectives will in some cases, be best achieved through the display of financial or non-financial information in notes, schedules or statements other than the statement of financial position or statement of financial performance in the financial report.

Study 3

Auditing for Compliance with Authorities—A Public Sector Perspective

Issued October 1994

This Study addresses aspects of the audit for compliance in the public sector which, in many countries, is subject to very different mandates and objectives than in the private sector. In a democratic system of government, accountability to the public and particularly, to its designated representatives, is an overriding aspect of the management of a public sector entity. Public sector entities are usually established by legislation and their operations governed by various authorities derived from legislation. Management of public sector entities is accountable for operating in accordance with the provisions of the relevant laws, regulations and other authorities governing them. Since legislation and other authorities are the primary means by which legislators control the raising and spending of money by the public sector, auditing for compliance with relevant authorities is usually an important and integral part of the audit mandate, or terms of engagement, for most audits of public sector entities. Because of the variety of authorities, their provisions may be conflicting with one another and may be subject to differing interpretations. Also, subordinate authorities may not adhere to the directions or limits prescribed by the enabling

legislation. As a result, an assessment of compliance with authority in the public sector requires considerable professional judgment and is of particular importance.

Study 4

Using the Work of Other Auditors—A Public Sector Perspective

Issued October 1994

This Study addresses using the work of other auditors, including both other external and internal auditors, in financial attest and compliance audits. It considers the matters an auditor has to take into consideration when using the work of another auditor and provides a public sector perspective to International Standard on Auditing (ISA) 600, *Using the Work of Another Auditor* and ISA 610, *Considering the Work of Internal Auditing*.

The Study considers the principles stated in the ISAs noted above and describes their applicability to the public sector. It also discusses some of the particular issues arising in the public sector when a principal auditor considers using the work of another auditor. The areas discussed deserving special attention are the autonomy of different tiers of government, the differing mandates of Higher Audit Institutions (HAI), and the particular problems surrounding using the work of other auditors in an international context.

Study 5

Definition and Recognition of Assets

Issued August 1995

This Study identifies and describes the variety of views which exist about whether, when and how specific assets should be measured and reported in the public sector. It considers and explores:

- The definition and recognition of assets;
- The effect of different bases of accounting on the definition and recognition of assets; and
- The issues associated with certain types of assets.

The Study acknowledges that the demand for government services has increased. This growth in demand has meant increasing competition for government services, stimulated by education standards, communication and community interest in government actions. Consequently, governments are under pressure to manage their assets efficiently and effectively. Accountability for efficiency and effectiveness of public sector asset management can be shown through better financial reporting. Better reporting provides a basis of understanding by the public, elected decision makers and by management. This, in turn, supports better decision making and asset allocation.

Study 6

Accounting for and Reporting Liabilities

Issued August 1995

This Study provides a public sector perspective on the definition and recognition of liabilities. It identifies, considers and explores views held on:

- The definition and classification of liabilities;
- The effect of different bases of accounting on accounting for and reporting liabilities; and
- The issues associated with certain types of liabilities.

The Study describes the variety of views which exist about whether, when and how certain liabilities should be measured and reported. Historically, governments have focused on their outstanding debt as a primary measure of the government's liabilities or indebtedness, particularly in formulating or assessing economic policy. However, governments assume a variety of commitments and obligations that give rise to other liabilities that are often unreported by governments. Yet information about all of a government's liabilities and exposure to potential liabilities is vital if governments are to manage their cash flow and make informed decisions about the financing of future services and resource allocation. While governments have liabilities similar to business enterprises, they also have other potential liabilities, such as recurring commitments under established social programs, guarantees and promises made by politicians. The study distinguishes liabilities, commitments and contingencies.

Study 7

Performance Reporting by Government Business Enterprises

Issued January 1996

This Study identifies principal users of performance information, considers the needs of those users, and outlines forms of reporting that could be available to meet those needs. The Study is thereby concerned primarily with the provision of information about an enterprise's performance (covering both financial and non-financial aspects of performance) supplementary to the information provided in financial statements, in the context of general purpose financial statements.

The need for this Study arises from the fact that financial standards on their own are not always sufficient to give an indication of the overall performance of a particular organization. Public sector bodies can differ from private sector enterprises in both their objectives and finance. Although government business enterprises are normally required to operate commercially and usually take the same legal form as private sector business enterprises, the combination of the fact that they often enjoy a monopoly position and the political context in which they operate means that the

user of financial reports can rely less on measures of performance such as return on capital employed. As a result, groups with an interest in the performance such as return on capital employed. As a result, groups with an interest in the performance of government business enterprises—governments, legislators, taxpayers and consumers—may have difficulty in making informed judgments about the efficiency and effectiveness of government business enterprises.

Government business enterprises may not be delivering services in circumstances that are even close to being a competitive market. So the test of relative market efficiency and effectiveness cannot always be applied. The issue therefore is how to formulate performance measures that will enable judgments about efficiency and effectiveness to be made. This Study considers how such measures might be defined and how a government business enterprise's performance in relation to these measures might best be reported to those with an interest in its performance.

Study 8

The Government Financial Reporting Entity

Issued July 1996

This Study considers the implications of different approaches to the definition of the government financial reporting entity and different techniques for the construction of government financial reports to the achievement of objectives of financial reports.

This Study is a companion to Study 1, *Financial Reporting by National Governments*, issued in March 1991, and Study 2, *Elements of the Financial Statement of National Governments*, issued in July 1993. Study 8 builds on the discussions and definitions from Studies 1 and 2. Consistent with Studies 1 and 2, the primary focus of this Study is on financial reporting of national governments. However, the matters it addresses may be equally applicable for other levels of governments (state, provincial and local governments).

It is hoped that this Study will lead to improvements in financial reporting by governments and greater comparability of financial reports both within and between jurisdictions.

Study 9

Definition and Recognition of Revenues

Issued December 1996

This Study examines concepts, principles and issues related to the definitions and recognition of revenues in the general purpose financial statements of national governments and other non-business public sector entities. Specifically, this Study identifies and discusses the definition and classification of revenues, issues with certain types of revenue and the effect of different bases of accounting on the definition and recognition of revenues.

Information on revenues is important in assisting users to assess the financial condition and performance of governments. Comparing revenues with expenses helps users to assess inter-period equity (that is, whether current revenues are sufficient to cover the costs of programs and services provided in the current period).

This Study extends Study 1, *Financial Reporting by National Governments*, issued in March 1991, and Study 2, *Elements of the Financial Statement of National Governments*, issued in July 1993. It is also a companion to Study 5, *Definition and Recognition of Assets*, Study 6, *Accounting for and Reporting Liabilities*, and Study 10, *Definition and Recognition of Expenses/Expenditures*.

The primary focus of this Study is on the financial statements prepared for national governments and for the entities and units they establish for the delivery of goods and services and the achievement of government objectives. However, the matters it addresses may be equally applicable for other levels of governments (state, provincial and local governments).

Study 10

Definition and Recognition of Expenses/Expenditures

Issued December 1996

This Study examines the concepts, principles and issues related to the treatment of expenses/expenditures in general purpose financial statements of governments and other non-business public sector entities.

Governments are under growing pressures not only to manage their funds effectively, but also to show their management has been effective. To achieve this, governments need complete information about their expenses/expenditures in order to assess their revenue requirements, the sustainability of their programs and their flexibility.

This Study extends Study 1, *Financial Reporting by National Governments*, issued in March 1991, and Study 2, *Elements of the Financial Statement of National Governments*, issued in July 1993. It is also a companion to Study 5, *Definition and Recognition of Assets*, Study 6, *Accounting for and Reporting Liabilities*, and Study 9, *Definition and Recognition of Revenues*.

The primary focus of this Study is on the financial statements prepared for national governments and for the entities and units they establish for the delivery of goods and services and the achievement of government objectives. However, the matters it addresses may be equally applicable for other levels of governments (state, provincial and local governments).

Study 11

Governmental Financial Reporting: Accounting Issues and Practices

Issued May 2000

This Study aims to assist governments at all levels in the identification of issues associated with financial reporting. Although some parts of the Study may relate to national governments only, other parts are applicable to all levels of government.

The Study contains a detailed description of both accrual and cash bases of accounting and provides examples of actual financial statements prepared under each basis. The document explains common practice within each basis of accounting, and provides examples of the variations within those bases. Governments wishing to change their basis of accounting or modify their accounting policies will be able to use this document as a source of information about a basis of accounting, including accounting policy issues associated with that basis and the format of financial statements prepared under that basis. This may assist governments in changing their basis of accounting and ultimately contribute to greater comparability within and between financial statements of governments.

Study 12

Perspectives on Cost Accounting for Governments

Issued September 2000

This Study intends to aid government financial officers and other government accountants in their efforts to develop and implement cost accounting. It provides government perspectives on cost accounting not available elsewhere, but it is not an in-depth exposition of the subject of cost accounting. The Study includes the following:

- Descriptions of the extent of governmental uses of cost accounting, recent growth, and prospects for future growth.
- Explanations of cost concepts that are relevant to various management objectives.
- Discussions of accounting standards issues where the resolution may affect the values used in the cost accounting exercise.
- Descriptions of how specific concepts and processes might be applied in designing and implementing a cost accounting system.
- Discusses major issues of importance to senior management.

It is designed to help fill the void by providing reference material for governments on this important topic.

Study 13

Governance in the Public Sector: A Governing Body Perspective

Issued July 2001

This Study outlines principles of governance and their application to public sector entities. Governance practices will need to be tailored according to the circumstances of individual public sector entities and the jurisdictions within which they operate. As entities develop and change over time, it will be necessary for the governing body, on an on-going basis, to review and amend governance practices. This Study aims to provide advice by defining common principles and recommendations concerning the governance of public sector entities in certain key areas. Its purpose is to consider an appropriate framework from the perspective of the governing body to assist in ensuring an appropriate balance between freedom to manage, accountability and the legitimate interests of different stakeholders. The Study defines common principles and recommendations concerning the governance of public sector entities with the objective of providing guidance to assist these entities in developing or reviewing their governance practices in such a way to enable them to operate in a more effective, efficient and transparent manner.

Study 14

Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities

Issued April 2002, Second Edition Issued December 2003, Third Edition Issued January 2011

This Study is intended to assist public sector entities in the process of adopting, or considering adopting, accrual basis International Public Sector Accounting Standards (IPSASs). The Study is primarily intended to assist public sector entities transitioning from the cash to the accrual basis but it may also be useful for entities currently reporting on an accrual basis and considering the adoption of IPSASs or entities complying with the financial reporting requirements of the Cash Basis IPSAS *Financial Reporting Under The Cash Basis of Accounting* and disclosing certain accrual basis information.

The Study includes a discussion of all IPSASs issued as at January 31, 2010 and certain topics not addressed by current IPSASs or Exposure Drafts. Where the Study discusses topics not addressed by current IPSASs or Exposure Drafts, the requirements of other authoritative accounting pronouncements such as International Financial Reporting Standards (IFRSs) are used to illustrate the practical implementation issues associated with that topic. IFRSs are published by the International Accounting Standards Board (IASB). The majority of the accrual basis IPSASs are based on IFRSs to the extent appropriate for the public sector. The use of IFRSs or other standards to illustrate such topics does not necessarily reflect the

views of the IPSASB on any issue. The Study is not an accounting manual, nor does it attempt to establish authoritative accounting practices or standards.

Occasional Paper 1

Implementation of Accrual Accounting in Government: The New Zealand Experience

Issued October 1994

The New Zealand public sector experienced major reform in the late 1980s and early 1990s. This reform changed public sector management from a system based on compliance with detailed and restrictive rules and budget cash limits to a performance and accountability-based regime. The successful implementation of these reforms demanded considerable effort at both strategic and operational levels and led to fundamental and extensive changes in both the management of public sector operations and also in the financial results of those operations. The New Zealand experience demonstrates that such change is not only possible but can also be highly successful.

This paper focuses on the move (migration was the colloquialism) by New Zealand government departments from cash to accrual accounting, and the project to produce the first set of Financial Statements for the New Zealand Government. The paper also attempts to draw out the key management issues in the implementation of full accrual accounting in a national government. The paper is written from the viewpoint of the Treasury which played a central role in the change.

Occasional Paper 2

Auditing Whole of Government Financial Statements: The New Zealand Experience

Issued October 1994

This paper describes the role played by the Audit Office in the development of the Crown financial statements. Following an explanation of the role of the Audit Office in New Zealand, the role played by the Audit Office is analyzed in terms of fundamental audit characteristics such as independence, criteria (in particular, accounting practices to provide a true and fair view in the absence of relevant accounting standards) and evidence. The audit and management processes involved in auditing the Crown financial statements—including planning, setting of materiality levels, project control, training and reporting—are then described. The paper concludes with lessons for other countries.

Occasional Paper 3

Perspectives on Accrual Accounting

Issued 1996

This paper aims to inform readers about a range of perspectives on accrual accounting from a number of contributors who have experience in implementing this accounting reform or who have observed its progress.

The IPSASB believes that by sharing perspectives of those who have been involved in the use of accrual accounting information for decision making purposes, others may gain insights into the value of this form of financial reporting to their own governments and other public sector entities.

The IPSASB deliberately set out to obtain the views of a wide range of people with a range of occupational backgrounds. The IPSASB also set out to focus on people who have experience of changing information outputs. The contributors to this paper are politicians, economists, academics, administrators and accountants.

Occasional Paper 4

The Delegation of Public Services in France: An original Method of Public Administration: Delegated Public Service

Issued September 2001

Government services can be provided in various ways. Usually they are delivered directly by government agencies. In some cases they can be contracted to private sector entities for them to deliver the public service under agreed conditions.

The public service can be said to be “delegated,” Such delegations occur, at the local authority level, in diverse fields such as water distribution, waste management and heating. Delegations are subject to special rules, and are contractual arrangements which balance the interests of the delegating authority and the private enterprise responsible for delivery of the service. Examples of collaborative arrangements of this type exist in other countries (Australia, Canada and New Zealand for example). This Occasional Paper describes the specific framework designed in France to manage the relationship between the parties and to ensure an adequate level of information and accountability.

Occasional Paper 5

Resource Accounting: Framework of Accounting Standard Setting in the UK Central Government Sector

Issued June 2002

The challenges for those moving to the accrual basis can be daunting. It can therefore be helpful for jurisdictions to know something of the issues, both anticipated and

unanticipated, which have arisen in jurisdictions adopting the accrual basis and how those issues have been dealt with.

This paper considers the experiences of the United Kingdom, which decided to move to an accrual basis for both budgeting and financial reporting in 1995. It highlights some of the key arguments influencing the decision to adopt an accrual system, not just for financial reporting, but also for budgeting. It also locates accrual based budgeting and reporting in a wider performance management context. It particularly considers how the UK undertook the task of creating the infrastructure for accrual accounting and budgeting in the form of a standard-setting framework and an authoritative manual of accounting policies, principles and treatments.

Occasional Paper 6

The Modernization of Government Accounting in France: The Current Situation, The Issues, The Outlook

Issued January 2003

This paper outlines the process of modernization of the French government accounting system that is currently underway. The paper is organized around three sections:

The current state of public sector accounting practices. This section outlines current practice. It explains that central government, national public establishments, local governments and social security funds do not follow the same accounting and budgetary practices. However, the present reform of central government accounting will lead to the adoption of uniform principles (including faithful representation, and the requirement to present a “true and fair view” of government accounts) and methods (accrual accounting), that French and foreign companies practice every day in their accounting systems.

The transition to accrual accounting: a goal for the near future. This section describes the consequences of the new Constitutional Bylaw 2001 on Budget Acts (known as the new Budgetary Constitution) on the government accounting system. The Budget Acts mandate the very clear distinction between accrual accounting and cash parliamentary appropriation. In France, a dual system will be applied: the national budget (appropriation) is and will continue to be expressed (and executed) on a modified cash basis, whereas the General Account of the Finance Administration (CGAF) (balance sheet and statement of revenue and expenditure) will be expressed on an accrual basis. The CGAFs (*Compte général de l'administration des Finances*) represent the financial statements of the central government.

Action: progress to date and future development. This section traces the progress made in the CGAF presentation since 1999. It outlines a description of the measures undertaken to develop and implement accrual accounting, including the evolution of the information system.

Occasional Paper 7

The Governmental Accounting System in Argentina

Issued January 2004

This Paper provides background to the development of the accounting profession in Argentina and its influence in the public sector. It also provides an overview of the evolution of the public sector accounting system in Argentina from the onset of the Argentine Confederation.

The cash basis of accounting was adopted in the public sector in Argentina in 1859. In 1947, the financial statements were modified to include recognition of expenses on a commitment basis. The Paper outlines the weaknesses in the public sector accounting system which led to subsequent reform of the Governmental Financial Administration and, consequently, the adoption of accrual accounting in 1993.

The Paper outlines challenges and issues that arose in data collection, practice and culture as part of the reform process. It also notes that the reform has brought about a positive impact in Government Financial Administration, including an increase in efficiency and effectiveness in public administration, and delivered more accurate information to support political decision-making.

Finally, the Paper outlines anticipated future developments in the Governmental Accounting System. These include improving management accounting in the public sector to further enhance decision-making, consolidating all public sector entities, creating a continuous training program for public sector employees and harmonizing the Argentine public sector generally accepted accounting principles with International Public Sector Accounting Standards (IPSASs).

Information Paper

The Road to Accrual Accounting in the United States of America

Published March 2006

This information paper considers the experiences of the United States of America in its movement to accrual accounting. It outlines the development of administrative arrangements for formal standards setting over 70 years at the local, state and federal Government levels in the US and highlights key factors shaping the standards setting structure. It also provides a detailed overview of the conversion to accrual accounting by state and local governments, the standards issued by the Government Accounting Standards Board to lead and support that conversion, and identifies key milestones in the conversion process.



International
Federation
of Accountants®

529 Fifth Avenue, 6th Floor, New York, NY 10017
T +1 (212) 286-9344 F +1 (212) 286-9570
www.ifac.org
ISBN: 978-1-60815-182-0