Invitation to Comment

ITC 12
May 2007

Request for Comment on a Proposed Revised Differential Reporting Regime for Australia and IASB *Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities*

Prepared by the
Australian Accounting Standards Board

Australian Government

Australian Accounting Standards Board

Commenting on this Exposure Draft

Constituents are strongly encouraged to respond to the AASB and the IASB. The AASB is seeking comment by 1 September 2007. This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments to the IASB, which are due by 1 October 2007. Comments should be addressed to:

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Respondents are asked to send their comments electronically to the IASB Website www.iasb.org using the 'Open to Comment' page

A copy of all non-confidential submissions to the AASB will be placed on public record on the AASB website: www.aasb.com.au.

Obtaining a Copy of this Exposure Draft

This Exposure Draft is available on the AASB website: www.aasb.com.au.
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PREFACE

Background

Australian Accounting Standards

The Australian Accounting Standards Board (AASB) makes Australian Accounting Standards to be applied by:

(a) entities required by the *Corporations Act 2001* to prepare financial reports;

(b) all reporting entities engaged in either for-profit, not-for-profit or public sectors; and

(c) any other entity that prepares general purpose financial reports.

Australian Accounting Standards that apply to annual reporting periods beginning on or after 1 January 2005 include Australian equivalents to International Financial Reporting Standards (IFRSs). IFRSs comprise accounting standards and interpretations. IFRSs are issued by the International Accounting Standards Board (IASB), and their adoption in Australia is in accordance with a strategic direction made by the Financial Reporting Council. The reasons for adoption of IFRSs in Australia are explained in CLERP Paper No. 9: *Corporate Disclosure – Strengthening the Financial Reporting Framework* (2002).

Although IFRSs are developed to apply to for-profit entities, the AASB has decided to continue to make transaction-neutral accounting standards. Accordingly, Australian Accounting Standards (including Australian equivalents to IFRSs) generally apply to both for-profit and not-for-profit entities, including public sector entities. An Australian equivalent to an IFRS uses the corresponding IFRS as the 'foundation' Standard to which the AASB adds material detailing its scope and applicability in the Australian environment. Additions are made, where necessary, to broaden the content of the Australian equivalent to an IFRS to cover not-for-profit entities including public sector entities, domestic, regulatory or other issues. In addition to making accounting standards that are Australian equivalents to IFRSs, the AASB also continues to make other Australian Accounting Standards that are specific to the not-for-profit or public sectors or that are purely of a domestic nature.

The references made in this Preface to public sector entities are generally references to only not-for-profit public sector entities.

Purpose of this Invitation to Comment

The purpose of this ITC is to invite comments from Australian constituents on:

(a) a proposed Revised Differential Reporting Regime for Australia; and

(b) the IASB Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities.

Should the proposals in this ITC proceed, the AASB envisages releasing an omnibus exposure draft that would propose amendments to the application paragraphs of the existing AASB Standards.

Summary of Main Proposals

The proposals in this ITC in relation to a proposed Revised Differential Reporting Regime for Australia would require:

(a) the application of Australian equivalents to IFRSs to the general purpose financial reports of:

    (i) for-profit entities that meet the IASB's definition of a publicly accountable entity;

    (ii) for-profit entities that are not identified as publicly accountable under the IASB's definition, but are important from a public interest perspective based on nominated size thresholds;

    (iii) not-for-profit entities that exceed nominated size thresholds; and

    (iv) public sector entities that exceed nominated size thresholds.

(b) the application of an Australian equivalent to the IFRS for SMEs to the general purpose financial reports of:

    (i) for-profit entities that do not meet the IASB's definition of a publicly accountable entity, or do not fall under (a)(ii) above;

    (ii) not-for-profit entities that fall below nominated size thresholds; and

    (iii) public sector entities that fall below nominated size thresholds.

(c) all financial reports on a public register or otherwise made available to the public at large to be regarded as general purpose financial reports.

Under the proposed revised differential reporting regime, the application of AASB Standards would no longer depend on whether entities are reporting entities, rather the focus of application would be general purpose financial reports. Accordingly, all entities that prepare general purpose financial reports would apply either the Australian equivalents to IFRSs or an Australian equivalent to the IFRS for SMEs, based on criteria that establish which set of these Standards would apply.

Entities required to apply an Australian equivalent to the IFRS for SMEs under the proposed revised differential reporting regime could choose to apply the full set of Australian equivalents to IFRSs.

Appendix 1 to this Preface depicts the proposed differential reporting regime in a diagram.

Implications of Main Proposals

The AASB notes that:

(a) as all financial reports on a public register or otherwise made available to the public at large would be regarded as general purpose financial reports, this could reduce the number of financial reports purported to be special purpose financial reports;

(b) some for-profit entities that are of small or medium size under the AASB's proposed size thresholds, and which are currently regarded as reporting entities, would no longer have to apply Australian equivalents to IFRSs and would have the choice of applying an Australian equivalent to the IFRS for SMEs;

(c) the proposals would not affect small proprietary companies. However, if they prepare and lodge financial reports (such as when the ASIC directs them or they are controlled

by a foreign company, or 5% of shareholders require them), they would be required to apply an Australian equivalent to the IFRS for SMEs;

(d) large proprietary companies would apply the Australian equivalents to IFRSs if they exceed either of the nominated size thresholds for important for-profit entities, or an Australian equivalent to the IFRS for SMEs if they fall below those thresholds, because they produce general purpose financial reports as a result of having to lodge their financial reports on a public register;

(e) for-profit entities (other than proprietary companies) that are not listed or deposit takers and prepare general purpose financial reports or purport to do so, would apply Australian equivalent to IFRSs if they exceed either of the proposed size thresholds for important for-profit entities and an Australian equivalent to the IFRS for SMEs if they fall below those thresholds;

(f) some not-for-profit private sector entities that prepare general purpose financial reports and presently apply the Australian equivalents to IFRSs, would be able to apply an Australian equivalent to the IFRS for SMEs, if they fall below proposed size thresholds;

(g) not-for-profit entities that are established as companies limited by guarantee would produce general purpose financial reports because their financial reports are on a public register. They would apply the Australian equivalents to IFRSs or an Australian equivalent to the IFRS for SMEs, depending on whether they fall above or below proposed size thresholds;

(h) some public sector entities that produce general purpose financial reports and presently apply the Australian equivalents to IFRSs, would be able to apply the Australian equivalent to IFRS for SMEs if they fall below proposed size thresholds;

(i) Statements of Accounting Concepts SAC 1 *The Reporting Entity Concept* and SAC 2 *Objective of General Purpose Financial Reporting* that form part of the AASB Framework would also be reconsidered in the process of finalising the alternative differential reporting regime;

(j) the application paragraphs of AASB 101 *Presentation of Financial Statements*, AASB 107 *Cash Flow Statements* and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, and also AASB 1031 *Materiality* and AASB 1048 *Interpretation and Application of Standard* would be the same as for other Standards; and

(k) the financial reports of proprietary companies that are exempted from lodging their financial reports under the grandfathering provision in section 1408(6) of the Corporations Act would be regarded as general purpose financial reports, if they are prepared in accordance with Australian Accounting Standards under the requirements of the Corporations Act.

Structure of this Invitation to Comment

The AASB has decided to:

(a) provide background on the existing Australian differential reporting regime in this Preface;

(b) identify its preliminary views on a proposed revised differential reporting regime for Australia in this Preface; and

(c) reproduce the IASB *Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities* without amendment as part of this ITC.

Background on existing Australian Differential Reporting Regime

A form of differential reporting has been in place in Australia since 1992. The concept of reporting entity is at the core of this differential reporting regime. The reporting entity concept is explained in Statement of Accounting Concepts SAC 1 *The Definition of the Reporting Entity*. SAC 1 also includes a definition of reporting entity. With the adoption of IFRSs in Australia in 2005, a slightly different definition has been adopted, which is based on that provided in IFRS 3 *Business Combinations*. AASB 3 *Business Combinations* defines a reporting entity as:[1]

> An entity in respect of which it is reasonable to expect the existence of users who rely on the entity's general purpose financial report for information that will be useful to them for making and evaluating decisions about the allocation of resources. A reporting entity can be a single entity or a group comprising a parent and all of its subsidiaries.

Most AASB Standards have the following application paragraph:

> This Standard applies to:
>
> (a) each entity that is required to prepare financial reports in accordance with Part 2M.3 of the Corporations Act and that is a reporting entity;
>
> (b) general purpose financial reports of each other reporting entity; and
>
> (c) financial reports that are, or are held out to be, general purpose financial reports.

Amongst major standard setters, Australia is the only jurisdiction that uses the concept of reporting entity in the application paragraphs of its accounting standards. In some jurisdictions, the standards apply whenever general purpose financial reports are prepared. This is also the approach taken in IASB Standards.

Entities incorporated under the Corporations Act 2001

Entities incorporated under the Australian *Corporations Act 2001* that are reporting entities currently have to comply with all the recognition, measurement and presentation and disclosure requirements of Australian Accounting Standards and Australian Interpretations (which include Australian equivalents to IFRSs). Incorporated entities that are not reporting entities but are required to prepare financial statements must comply with AASB 101 *Presentation of Financial Statements*, AASB 107 *Cash Flow Statements* and AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, and also AASB 1031 *Materiality* and AASB 1048 *Interpretation and Application of Standards*. Entities incorporated under the Corporations Act could be for-profit entities or not-for-profit entities.

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1 The above definition of a reporting entity differs from that in IFRS 3 in two respects. The first difference is the highlighting of both the 'confirmatory' and 'predictive' roles of information in the Australian definition by noting the usefulness of information for users for both 'making' and 'evaluating' decisions. The second difference relates to the certainty of the existence of users. In this respect, the IFRS 3 definition requires users of general purpose financial reports to exist whereas the AASB definition as set out in AASB 3 only requires a reasonable expectation that those users exist.

Under the Corporations Act, disclosing entities, public companies, large proprietary companies, companies limited by guarantee and registered schemes must prepare and lodge financial reports that comply with accounting standards. Large proprietary companies are those companies that meet two of the following thresholds:

(a) the consolidated gross operating revenue for the financial year of the company and the entities it controls (if any) is $10 million or more;

(b) the value of the consolidated gross assets at the end of the financial year of the company and the entities it controls (if any) is $5 million or more; and

(c) the company and the entities it controls (if any) have 50 or more employees at the end of the financial year.

The thresholds have been reviewed recently and are likely to be raised[2]. The effect of the Corporations Act size test is to remove the external reporting obligations for small proprietary companies. These companies would need to apply AASB Standards only if they choose or are required to present general purpose financial reports[3].

Other entities

Entities not incorporated under the Corporations Act, which include many not-for-profit entities and most public sector entities apply the requirements of the Australian Accounting Standards and Australian Interpretations when they are reporting entities. In respect of public sector entities, such Accounting Standards include any relevant public sector specific accounting standards such as AAS 27 *Financial Reporting by Local Governments*, AAS 29 *Financial Reporting by Government Departments* and AAS 31 *Financial Reporting by Governments*. Under these Standards, local governments and most government departments are reporting entities.

Proposed Revised Australian Differential Reporting Regime

IASB approach, including the proposed IFRS for SMEs

IFRSs are designed to apply to the general purpose financial statements and other financial reporting of profit-oriented entities[4]. A separate IFRS is planned to apply to the general purpose financial statements of, and other financial reporting by, entities that in many countries are known as Small and Medium-sized Entities (SMEs).

In its ED of A Proposed IFRS for Small and Medium-sized Entities, the IASB uses public accountability to differentiate between entities that should apply full IFRSs and those that can apply the IFRS for SMEs. According to the IASB's definition, an entity has public accountability if:

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2 The Simpler Regulatory System Bill was introduced into the House of Representatives on 24 May 2007 and includes a change to the thresholds for financial reporting of large proprietary companies. The revenue and assets thresholds will be increased to $25m and $12.5m respectively and the threshold regarding the number of employees will remain at 50 employees. The Bill also replaces the terms 'gross operating revenue' and 'gross assets' with the terms 'revenue' and 'assets'.

3 Under Sections 292(2), 293 and 294 of the Corporations Act, small proprietary companies must prepare and lodge financial reports in certain circumstances such as when ASIC directs them, or they are controlled by a foreign company, or 5% of shareholders vote to have a financial report.

4 Preface to International Financial Reporting Standards, paragraph 9.

(a) it files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity.

The SMEs that the IASB intends the IFRS for SMEs to apply to are entities that:

(a) do not have public accountability; and

(b) publish general purpose financial statements for external users.

Examples of external users given in the ED of A proposed IFRS for SMEs include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

The ED of A Proposed IFRS for SMEs proposes some simplifications of recognition and measurement principles contained in the full IFRSs. These simplifications have been considered by the IASB as being appropriate in the light of users' needs and cost-benefit considerations. The ED also includes disclosure requirements that are significantly reduced from full IFRSs.

The rationale for proposed changes

The Basis for Conclusions in this Preface explains the AASB's rationale for its proposals for revising the current differential reporting regime. Currently, Australian Accounting Standards apply to (1) reporting entities that prepare financial reports under the Corporations Act, (2) general purpose financial reports of other reporting entities; and (3) financial reports that are, or are held out to be, general purpose financial reports. The main reasons for proposing changes are:

(a) the reporting entity concept is not used internationally for the purpose of determining the application of accounting standards. Amongst major standard setters, some of which have a differential reporting regime in place, Australia is the only jurisdiction that uses the concept of reporting entity in the application paragraphs of its accounting standards for differential reporting purposes;

(b) Australia has adopted IFRSs, which apply to general purpose financial reports, rather than reporting entities; and

(c) under the current differential reporting regime, various interpretations have been developed around the reporting entity concept that have had mixed success, such as an interpretation that non-reporting entities should apply the recognition and measurement requirements in Standards, but need only apply some of the presentation and disclosure requirements.

The AASB considers that the development of the SMEs project by the IASB provides an opportunity to address its approach to differential reporting. The AASB also concluded that it should outline its preliminary views on the manner in which a forthcoming IFRS for SMEs might be adopted in Australia to provide Australian constituents with a framework within which to consider the IASB's ED of A Proposed IFRS for SMEs.

AASB's Preliminary Views

The key element of the AASB's proposed revised differential reporting regime would be a two-tier approach under which entities preparing general purpose financial reports would either apply Australian equivalents to IFRSs, or an Australian equivalent to the IFRS for SMEs. The proposed size thresholds are tentative and based on preliminary enquiries. The AASB expect to arrive at a final decision on the nature and quantum of size thresholds through a process involving further research and canvassing the views of constituents.

For-profit entities

In respect of for-profit entities that prepare general purpose financial reports, the AASB's preliminary view is that:

(a) publicly accountable for-profit entities would apply Australian equivalents to IFRSs;

(b) for-profit entities that do not satisfy the definition of a publicly accountable entity, but are viewed as being important from a public interest perspective because of their large size, also would apply Australian equivalents to IFRSs; and

(c) other for-profit entities that are not publicly accountable or not otherwise included in (b) above, would apply an Australian equivalent to the IFRS for SMEs. Such entities could choose to apply the full set of Australian equivalents to IFRSs.

A publicly accountable for-profit entity would have the same definition as that proposed in the ED of A Proposed IFRS for SMEs. (See the section on the IASB approach above).

Entities falling under (b) would be regarded as important if they exceed either of the following size thresholds:

- Consolidated Revenue for the financial year of the entity and the entities it controls (if any) $500m; and
- Consolidated Assets at financial year end of the entity and the entities it controls (if any) $250m.

Not-for-profit private sector entities

Under the proposed revised differential reporting regime, Australian Accounting Standards would apply to not-for-profit private sector entities that prepare general purpose financial reports. The AASB acknowledges that, on cost-benefit grounds, there is a case for differential reporting in this sector. The AASB's preliminary view is that size thresholds should be applied to not-for-profit private sector entities that prepare general purpose financial reports so that:

(a) not-for-profit private sector entities exceeding either of two size thresholds would apply Australian equivalents to IFRSs; and

(b) not-for-profit private sector entities that fall under the two size thresholds would apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalents to IFRSs). Such entities could also choose to apply the full set of Australian equivalents to IFRSs.

The following thresholds are proposed:

- Consolidated Revenue for the financial year of the entity and the entities it controls (if any) $25m; and
- Consolidated Assets at the end of the financial year of the entity and the entities it controls (if any) $12.5m.

The AASB considers that there may be a need for a third tier of simpler reporting requirements for smaller not-for-profit private sector entities since they might find adoption of an Australian equivalent to the IFRS for SMEs burdensome on cost-benefit grounds. However, the need for a third tier would be mitigated if a future IFRS for SMEs requires fewer disclosures than those proposed in the ED of A Proposed IFRS for SMEs.

Public sector entities

Under the proposed revised differential reporting regime, Australian Accounting Standards would apply to public sector entities that prepare general purpose financial reports. However, the AASB acknowledges that there is a case for differential reporting in this sector. The AASB's preliminary view is that size thresholds as described above for not-for-profit private sector entities should also be applied to public sector entities that prepare general purpose financial reports so that:

(a) public sector entities exceeding either of two size thresholds would apply Australian equivalents to IFRSs; and

(b) public sector entities that fall under the two size thresholds would apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalents to IFRSs). These entities could also choose to apply the full set of Australian equivalents to IFRSs.

The size thresholds proposed are:

- Consolidated Revenue for the financial year of the entity and the entities it controls (if any) $25m; and
- Consolidated Assets at the end of the financial year of the entity and the entities it controls (if any) $12.5m.

General Purpose Financial Reports

AASB 101 *Presentation of Financial Statements* defines a general purpose financial report as "a financial report intended to meet the information needs common to users who are unable to command the preparation of reports tailored so as to satisfy, specifically, all of their information needs". AASB 101 also states that general purpose financial reports include those that are presented separately or within another public document such as an annual report or a prospectus[5].

Consistent with the above definition, the AASB has tentatively decided that, under a revised financial reporting regime, all financial reports that are on a public register, such as those

5 The IASB's ED of A Proposed IFRS for SMEs also adds that general purpose financial statements are directed towards the common information needs of a 'wide range' of users (paragraph P7).

prepared and lodged with the Australian Securities and Investments Commission (ASIC) under the Corporations Act, or otherwise made available to the public at large, such as those tabled in a Parliament, would be regarded as general purpose financial reports. In addition, notwithstanding a company being exempt from lodging under the Corporations Act, if it is required under that Act to prepare a financial report in accordance with Australian Accounting Standards, its financial report is regarded as a general purpose financial report. This decision does not mean that Australian equivalents to IFRSs would necessarily apply to such financial reports because, under the proposed revised differential reporting regime, the relevant entity may be classified as being subject to an Australian equivalent to the IFRS for SMEs.

Interim Financial Reports

The AASB has not addressed the effects of the proposed revised differential reporting regime on interim financial reporting in Australia. This will be addressed once the proposals on the alternative differential reporting regime are further developed.

Harmonisation with New Zealand

The Trans-Tasman Accounting and Auditing Standards Advisory Group (TTAASAG) was established to foster harmonisation between Australia and New Zealand and to encourage co-operation between the standard setting bodies of the two countries. Although the AASB and FRSB have both adopted IFRSs and co-operate and work together on projects, there are some differences between Accounting Standards in the two jurisdictions mainly arising from the regulatory regimes.

The proposed IFRS for SMEs could be adopted in both Australia and New Zealand. The AASB welcomes comment from constituents on whether Australia and New Zealand should seek to achieve harmonisation in their reporting requirements regarding SMEs.

Request for Comments

Comments are invited on:

(a) any of the proposals in the IASB's Exposure Draft of A Proposed IFRS for Small and Medium-sized Entities, including the questions set by the IASB in the 'Invitation to Comment' section, in the light of proposals made by the AASB under the proposed revised differential reporting regime; and

(b) any of the AASB's preliminary views on differential reporting set out in this Preface and the specific questions on these views set out below.

In relation to the proposals in the IASB's Exposure Draft, constituents are strongly encouraged to respond to both the AASB and the IASB. The AASB is seeking comment by 1 September 2007 in relation to both (a) and (b). This will enable the AASB to consider Australian constituents' comments in the process of formulating its own comments on the Exposure Draft of A Proposed IFRS for SMEs to the IASB, which are due by 1 October 2007.

The AASB would prefer that respondents supplement their opinions with detailed comments, whether supportive or critical, on the major issues. This would include general comments on any aspect of the proposed revised differential reporting regime, and the views expressed by the AASB. The AASB regards both critical and supportive comments as essential to a balanced review and will consider all submissions, whether they address all specific matters, additional issues or only one issue. To be able to respond to the questions in their appropriate

context, respondents are advised to read the AASB Basis for Conclusions at the end of this Preface explaining the process that led to the AASB's preliminary views.

Specific Matters for Comment

In addition, the AASB would value comments on the following questions:

(a) do you agree with changing the application focus of Australian Accounting Standards from 'reporting entity' to 'general purpose financial reports'?

(b) if it is considered desirable to retain the reporting entity concept as the basis for differential reporting, what improvements could be made to remove related concerns (see paragraph BC6) and make it more effective?

(c) do you support the proposal to apply the IASB's definition of a publicly accountable entity to differentiate between for-profit entities that apply Australian equivalents to IFRSs and for-profit entities that apply an Australian equivalent to the IFRS for SMEs?

(d) in respect of for-profit entities that do not satisfy the IASB's definition of a publicly accountable entity, but are viewed as being important from a public interest perspective because of their large size:

  (i) do you agree that such entities should in the public interest apply Australian equivalents to IFRSs and that it is appropriate to use size thresholds to identify these entities?

  (ii) do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds, and why?

(e) since the IASB's ED of A Proposed IFRS for SMEs has been developed with only for-profit entities in mind, do you agree it is appropriate to adopt the forthcoming IASB's IFRS for SMEs (after inclusion of Aus paragraphs similar to those included in Australian equivalents to IFRSs) in a differential reporting regime in respect of not-for-profit private sector entities and public sector entities?

(f) in respect of not-for-profit private sector entities:

  (i) is there a need for differential reporting in the not-for-profit private sector? If yes, do you agree with using size thresholds to distinguish between not-for-profit private sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalent to IFRSs)?

  (ii) do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate size thresholds and why?

  (iii) not-for-profit entities that meet the thresholds of $25m revenue and $12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of $500m revenue and $250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of not-for-profit entities. Do you agree?

(iv) both private sector not-for-profit entities and public sector entities that meet the thresholds of $25m revenue and $12.5m assets would need to prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?

(v) do you think a third tier of simpler reporting requirements should be added to cater for smaller not-for-profit private sector entities that prepare general purpose financial reports? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified?

How would your answer to this question differ if the forthcoming IFRS for SMEs has fewer disclosures than the ED of A Proposed IFRS for SMEs?

(g) in respect of public sector entities:

(i) is there a need for differential reporting in public sector? If yes, do you agree with differentiating based on size thresholds between public sector entities that should apply Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in Australian equivalents to IFRSs)?

(ii) do you agree with the proposed size thresholds? If you do not agree, what do you consider to be the appropriate thresholds and why?

(iii) public sector entities that meet the thresholds of $25m revenue and $12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. In contrast, non-publicly accountable for-profit entities would only be required to apply the Australian equivalents to IFRSs when they meet the thresholds of $500m revenue and $250m assets. The AASB has justified this difference based on the higher degree of public interest in the activities of public sector entities. Do you agree?

(iv) both public sector entities and not-for-profit private sector entities that meet the thresholds of $25m revenue and $12.5m assets would prepare their general purpose financial reports in accordance with the Australian equivalents to IFRSs. The AASB has justified the common size thresholds for both types of entities based on a view that there is an equivalent degree of public interest in the activities of these two types of entities. Do you agree?

(v) do you think another tier of simpler reporting requirements should be established to cater for smaller public sector entities? If so, what should those simpler reporting requirements be and how would the category of entities applying those requirements be identified?

(h) do you think there are approaches, other than the proposed approach based on public interest and employing size thresholds, that would reasonably distinguish between entities that should apply the Australian equivalents to IFRSs and those that should apply an Australian equivalent to the IFRS for SMEs? If there are appropriate alternative approaches, please explain.

(i) do you agree that, consistent with the IASB's view of a general purpose financial report, under a revised Australian differential reporting regime:

  (i) all financial reports that are available on a public register, such as those prepared and lodged with the ASIC under the Corporations Act, should be regarded as general purpose financial reports; and

  (ii) all financial reports that are made available to the public at large, such as those tabled in a Parliament, also should be regarded as general purpose financial reports?

  If you do not agree, explain why.

(j) do you agree that, notwithstanding an entity having been exempted from filing a financial report with the ASIC, its financial report should be regarded as a general purpose financial report if it is required by the Corporations Act to be prepared in accordance with Australian Accounting Standards?

(k) the Corporations Act includes three size thresholds respectively for revenue, assets and the number of employees to distinguish between small and large proprietary companies. The AASB's proposed size thresholds only include the monetary thresholds of revenue and assets. Do you think that, except for the case of for-profit entities that are not publicly accountable but are important from a public interest perspective, a further size threshold for the number of employees would be appropriate under the proposed differential reporting for not-for-profit private sector entities and public sector entities?

(l) considering the AASB's tentative decision to base the second tier of reporting requirements on the IASB's pending IFRS for SMEs, do you consider that the IASB's ED of A Proposed IFRS for SMEs is appropriate for Australian circumstances. If not, explain how it could be improved, or what other options are more appropriate and why?

(m) do you think adaptations, or additional guidance, are needed (in addition to Aus paragraphs that would be included consistent with Australian equivalents to IFRSs) for not-for-profit private sector entities and public sector entities if the IASB's IFRS for SMEs were adopted in Australia?

(n) do you think Australia and New Zealand should seek to achieve harmonisation in their reporting requirements regarding SMEs?

(o) are there any regulatory issues or other issues arising in the Australian environment that may affect the implementation of the preliminary views?

(p) do you think that the overall benefits that would arise from the proposals would exceed the overall costs? If you are an entity that prepares a general purpose financial report or would need to do so under the proposals, please advise us of any increased costs or any savings that would result from the proposals, and if possible, quantify them.

(q) would the preliminary views be in the best interests of the Australian economy?

AASB Basis for Conclusions

Background

BC1 The applicability of accounting standards in Australia is presently determined through a combination of legislation, application paragraphs within the AASB's Standards and pronouncements of the accounting profession on conformity with accounting standards. The legislation includes the Corporations Act in respect of corporate entities, and various Commonwealth, State and Territory statutes and regulations for public sector entities and unincorporated associations. The AASB's application paragraphs generally scope in reporting entities (five Standards apply also to non-reporting entities required to prepare financial reports under the Corporations Act)[6] and also scope in any general purpose financial reports. The accounting profession's literature on conformity with accounting standards is based on the concepts of reporting entity and general purpose financial reports.

BC2 One view is that the application of accounting standards is most appropriately dealt with as a matter of government policy, and this is the case in many jurisdictions outside Australia. Others take the view that the AASB should play a role in determining the application of its Standards.

BC3 In view of the fact that the AASB already plays a role in determining the application of its Standards, it concluded that it should address issues that have been raised about using the reporting entity concept to determine which entities should apply AASB Standards. Those issues include lack of consistency in identifying reporting entities from non-reporting entities by preparers.

BC4 With the initiation of the SMEs project by the IASB, revisiting the Australian differential reporting framework has gained higher priority, particularly since the IASB's SMEs project contemplates a differential reporting regime using the notion of 'public accountability' rather than the reporting entity concept.

BC5 The AASB concluded that the development of the SMEs project provides an opportunity to address the current approach to differential reporting in Australia. The AASB also concluded that it should outline its preliminary views on the manner in which an Australian equivalent to the IFRS for SMEs might be used in Australia to provide Australian constituents with a framework within which to consider the IASB's ED of A Proposed IFRS for SMEs.

Use of reporting entity for differential reporting purposes

BC6 The AASB acknowledges that the reporting entity concept's focus on the users of financial reports is consistent with the objective of financial reporting. However, the AASB concluded that because of certain issues noted below, there is a need to reconsider the existing differential reporting regime based on the reporting entity concept:

(a) the concept is not used internationally for the purpose of determining the application of accounting standards. Amongst major standard setters, some of

6 AASB 101 *Presentation of Financial Statements*, AASB 107 *Cash Flow Statements*, AASB 108 *Accounting Policies, Changes in Accounting Estimates and Errors*, AASB 1031 *Materiality* and AASB 1048 *Interpretation and Application of Standards*.

which have a differential reporting regime in place, Australia is the only jurisdiction that uses the concept of reporting entity in the application paragraphs of its accounting standards for differential reporting purposes. Other standard setters, including the IASB, require their standards to be applied in general purpose financial reports;

(b) Australia has adopted IFRSs, which apply to general purpose financial reports, rather than reporting entities. The adoption of IFRSs in Australia makes it necessary to react to major international developments in financial reporting, such as the IASB's SMEs project, in a timely manner with a view to enhancing international comparability of financial reports;

(c) various interpretations have been developed around the concept that have had mixed success, such as an interpretation that non-reporting entities should apply the recognition and measurement requirements in Standards, but need only apply some of the presentation and disclosure requirements;

(d) the concept initially focuses on the entity that reports rather than the general purpose financial report that it prepares for the purpose of the accounting standards. This may lead some entities that prepare general purpose financial reports, failing to apply all the AASB Standards on the basis that the entity is perceived as being a non-reporting entity. The lodgement of a financial report on a public register (such as that of the ASIC), or otherwise making it available to the public at large (such as tabling of such a report in a Parliament), makes that financial report a general purpose financial report, which would therefore mean that all the AASB Standards would be applied; and

(e) a concept of reporting entity is already being used internationally (including in Australia under Australian equivalents to IFRSs) for the purpose of delineating the boundaries of an entity for reporting purposes and, accordingly, it is a source of confusion that the same notion is used for two separate purposes.

Potential alternative approaches

BC7 The AASB has considered a number of potential alternatives to the current differential reporting regime in Australia. The different options examined utilise the notions of reporting entity, general purpose financial report and public accountability to various degrees, and include:

(a) relying on the reporting entity concept either as an overarching concept or in combination with size thresholds;

(b) drawing on the notion of publicly accountable (as defined in the IASB's ED of A Proposed IFRS for SMEs) to distinguish reporting standards for for-profit corporate entities, but retaining the current reporting entity approach for not-for-profit and non-corporate entities;

(c) using publicly accountable (as defined in the IASB's Exposure Draft of A Proposed IFRS for SMEs) for for-profit entities and having a modified notion of publicly accountable for use by not-for-profit entities, including public sector entities; and

(d) relying on the notion of a general purpose financial report as an overarching notion either in combination with the notion of publicly accountable (as defined in the IASB's ED of A Proposed IFRS for SMEs) or in combination with a modified notion of publicly accountable.

BC8 The AASB concluded that it should focus on general purpose financial reports, rather than the reporting entity concept, and make use of the notion of publicly accountable to the extent practicable. The AASB considers that the notion of publicly accountable has a focus on the users of financial reports and should be able to be readily implemented in the for-profit sector. The AASB also notes that the notion of publicly accountable is being used, and promoted internationally, by the IASB in relation to the for-profit sector.

Applicability of the IASB's notion of publicly accountable to for-profit entities in Australia

BC9 The IASB's ED of A Proposed IFRS for SMEs makes it clear that the types of entities that are treated as being publicly accountable is a matter for each local jurisdiction to decide. While the IASB's definition would hold in relation to Australian entities that are publicly accountable, there are other entities in the Australian context that do not satisfy the IASB's definition of a publicly accountable entity, but might rationally also be treated like publicly accountable entities in respect of their reporting obligations. For example, the AASB concluded that it is appropriate to require certain non-publicly accountable entities to apply the same reporting requirements as publicly accountable entities on the grounds that they are important from a public interest perspective because of their large size. This is consistent with the argument that public accountability arises in substance from the existence of public interest in the entity, and that it should not be restricted to investors' interests in a listed entity or depositors' interests in a deposit taker.

Applicability of the IASB's notion of publicly accountable to not-for-profit entities in Australia

BC10 The AASB notes that the IASB's definition of publicly accountable has been developed from a for-profit entity perspective. Accordingly, it is understandable that there would be concerns as to the applicability of the IASB's definition of publicly accountable to not-for-profit entities, including public sector entities. While the IASB's definition of publicly accountable does not function well in a not-for-profit context, the AASB discussed different views on extending that definition to not-for-profit private sector and public sector entities.

BC11 Some may argue that charities that collect donations and allocate them to various causes on behalf of donors are, in effect, entities entrusted with deposits and therefore fall within the second arm of the IASB's proposed notion of publicly accountable. Others may argue that, since donors are acting of their own free will and are not seeking a financial return, there is no public accountability. Yet others may take a public interest perspective arguing that some not-for-profit entities, such as charities, that are designated gift recipients and are also effectively being subsidised by public funds (loss of tax revenues due to donors claiming tax deductions) may be publicly accountable in the general sense of that term because of high public interest in their activities. However, there are other types of private sector not-for-profit entities such

as clubs and associations which might not be established primarily for the public interest, but might receive favourable income tax treatment.

BC12 Some may also argue that the IASB's proposed notion of publicly accountable could be extended to public sector entities. Entities in the public sector that use public money to deliver services and entities that have the ability to tax, levy or rate could be regarded as publicly accountable on the basis that they are entrusted with public funds. Others argue that even if such entities are not publicly accountable in terms of strict conformity with the IASB's notion, they are publicly accountable in the general sense of that term because they have a responsibility to act in the public interest.

Defining publicly accountable for the Australian context

BC13 The AASB considered preparing its own definition of publicly accountable to suit the Australian reporting regime. The AASB considered a number of potential approaches, including:

(a) defining publicly accountable as a single notion to be applicable to both for-profit entities and to not-for-profit entities, including public sector entities;

(b) adopting the IASB's proposed notion, or a modified version thereof, in respect of for-profit entities and defining a separate notion of publicly accountable for not-for-profit entities, including public sector entities;

(c) defining a notion of publicly accountable separately in respect of for-profit entities and not-for-profit private sector and public sector entities without regard to the IASB's proposed notion; and

(d) adopting the IASB's proposed notion, or a modified version thereof, in respect of for-profit entities and deeming public sector entities and certain not-for-profit entities as publicly accountable in the general sense of that term.

BC14 The AASB initially showed a preference for approach (a) and considered a generic definition of publicly accountable. The objective was to arrive at a definition that encompasses, and extends, the IASB's definition for private for-profit entities and has attributes that makes it readily applicable in relation to public-for-profit, private not-for-profit and public not-for-profit entities.

BC15 Accordingly, the AASB considered as a starting point a definition that was based on proposals in the IASB Discussion Paper[7] (that preceded the IASB's Exposure Draft). Under this definition, an entity would be publicly accountable if:

(i) there is a high degree of outside interest in the entity from non-management investors or other stakeholders, and those stakeholders depend primarily on external financial reporting as their only means of obtaining financial information about the entity; or

(ii) the entity has an essential public service responsibility because of the nature of its operations; or

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7 Discussion Paper, Preliminary Views on Accounting Standards for Small and Medium-sized Entities, June 2004.

(iii) the entity's operations are of economic significance in the community.

BC16 The definition was considered to have the potential to encompass entities beyond those intended by the latest IASB definition included in the ED of A Proposed IFRS for SMEs. It was argued that entities falling under subparagraph (i) in BC15 could include listed entities, or entities that hold assets in a fiduciary capacity to a broad group of outsiders, as well as other entities so long as they have the noted characteristics.

BC17 The AASB did not proceed with using the above definition of publicly accountable for the Australian context on the grounds that:

(a) the definition is 'too general' in nature and might lead to classifying too many entities as publicly accountable. The term 'high degree of outside interest' is subject to interpretation, and of itself, would not lead to consistent outcomes in identifying publicly accountable entities;

(b) the feedback from the IASB's constituents and the SMEs Working Group indicated that economic significance does not automatically result in an entity being publicly accountable; and

(c) the essential service criteria may automatically classify small utilities as publicly accountable, which may not be warranted.

BC18 The AASB concluded that approaches (b) and (c) in paragraph BC13 would not be appropriate because having multiple definitions of the same term can create confusion.

BC19 In relation to approach (d) the AASB considered that it is difficult to apply the notion of 'publicly accountable in the general sense of that term' since it is not defined and could not be readily implemented. In particular, the AASB considered it would be highly problematic to identify suitable criteria to distinguish publicly accountable from non-publicly accountable not-for-profit private sector entities.

Approach based on public interest

BC20 The AASB concluded that in cases where the notion of a publicly accountable entity as defined by the IASB cannot be used for differential reporting, an approach based on the notion of public interest and employing size thresholds should be adopted to distinguish between the classes of entities within each sector that apply the different reporting requirements. Employing size thresholds would provide certainty of financial reporting requirements to preparers and auditors in particular.

BC21 Public interest in the affairs of an entity arises from the impact the entity has on the economic and social aspects of public life. Public interest in an entity's affairs can arise from factors such as:

(a) investment and other stakeholdings in the entity;

(b) entrusting funds to the entity for various purposes;

(c) concern about the impact of the activities of the entity on economic and social life because of the entity's economic importance or public service responsibility;

(d) the need to oversee the use by the entity of public funds;

(e) the need to scrutinise the fund collecting function of an entity that has the ability to tax, rate or levy the public; and

(f) the entity's monopoly or oligopoly[8] position or large size.

BC22 There is public interest in the activities of public sector entities. Community expectations about public sector performance and conduct are high. The primary reason for this is that the resources at the disposal of the executive and/or public servants have been acquired compulsorily.

BC23 Many not-for-profit private sector entities are the focus of public interest because of the nature of their activities. Entities that receive public funds or privileged access to public assets, enjoy tax concessions or rely on funds from a large membership base and have a significant impact on public life would attract various degrees of public interest.

BC24 The AASB considers that an approach based on the notion of public interest and employing size thresholds is consistent with the IASB's views outlined in the ED of A Proposed IFRS for SMEs. The IASB states that "economic significance may be more relevant to matters of political or societal accountability and that whether such accountability requires general purpose financial statements using full IFRSs is a matter best left to local jurisdictions to decide"[9]. The ED notes that, in deciding which entities should be required or permitted to use the IFRS for SMEs, individual jurisdictions may choose to prescribe quantified size thresholds. Such jurisdictions may choose to define economic significance based on size thresholds such as total assets, total income, number of employees, degree of market dominance, and nature and extent of external borrowings.

BC25 Accordingly, the AASB notes that consistent with the IASB's view that economic significance should be determined at the jurisdiction level, more specific criteria such as an entity's size has the potential to be a more robust determinant of entities that should apply Australian equivalents to IFRSs. The AASB also considers that issues of political or societal accountability are directly related to the public interest perspective and provide relevant justification to use the degree of public interest to set thresholds distinguishing the reporting requirements applicable to different classes of entities both in the for-profit sector, not-for-profit private sector and public sector.

Proposed differential reporting regime

Different tiers of reporting requirements

BC26 The AASB considers that two tiers of reporting requirements would be needed to cater for the reporting needs of entities that prepare general purpose financial reports. The first tier would comprise the Australian Accounting Standards (which include the Australian equivalents to IFRSs). The second tier would include less onerous reporting requirements, and could either:

(a) be based on the IASB's pending IFRS for SMEs, or

8 'Monopoly' refers to a situation where an organisation has complete control of the supply of particular goods or services. 'Oligopoly' refers to a situation where a few organisations have control over the supply of particular goods or services.

9 IASB Exposure Draft of A Proposed IFRS for SME (February 2007), paragraph BC40.

(b) constitute a separate Australian small GAAP comprising simplified reporting requirements; or

(c) be the same as Australian Accounting Standards, but with disclosure exemptions.

BC27 The AASB concluded that the second tier of reporting requirements should be based on the IASB's pending IFRS for SMEs for the following reasons:

(a) it would be inefficient to develop and maintain a separate Australian small GAAP, since it would need additional resources and would involve additional effort for constituents to adopt; and

(b) basing the requirements on the IASB's IFRS for SMEs would enhance the international comparability of Australian financial reports, and would facilitate maintaining the requirements consistent with the IASB's policy of regular periodic maintenance of its IFRS for SMEs; and

(c) a tier constituting the Australian Accounting Standards with disclosure exemptions could be more onerous for entities to apply because the IFRS for SMEs includes simplifications to recognition and measurement requirements.

BC28 Despite the AASB's conclusion to base the second tier of reporting requirements on the IASB's pending IFRS for SMEs, it considers it to be a tentative decision and therefore notes that the IFRS for SMEs should not be seen as the only option in developing a differential reporting framework. The AASB seeks comment on whether the IFRS for SMEs is appropriate for Australian circumstances, or if it could be improved.

For-profit entities

BC29 The AASB initially considered having three different categories of reporting in respect of for-profit entities that prepare general purpose financial reports, encompassing:

(a) publicly accountable for-profit entities (as defined by the IASB). These entities would apply Australian equivalents to IFRSs;

(b) non-publicly accountable for-profit entities that are of small and medium size (SMEs). These entities would apply an Australian equivalent to the IFRS for SMEs; and

(c) for-profit entities that, by virtue of their particular circumstances, would be required to prepare financial statements using recognition and measurement requirements of Australian equivalents to IFRSs but have reduced disclosure requirements.

BC30 Category (c) would provide relief to those entities concerned about the burden of disclosure requirements, rather than recognition or measurement requirements. An example of an entity in this category is a wholly-owned subsidiary of an entity that applies Australian equivalents to IFRSs. These entities need to apply the recognition and measurement requirements of Australian equivalents to IFRSs to facilitate consolidation as part of a group.

BC31 The AASB concluded that it should not propose a third category on the grounds that:

(a) the creation of a third category should be consistent with the reasons underlying the creation of the second category, that is, the existence of different users for financial reports and cost-benefit reasons. Otherwise, there are likely to be overlaps with other categories. It was noted that although, in some circumstances, relief from full disclosures may contain the cost of reporting, there are no indications that there are different users involved;

(b) it seems inequitable to provide more disclosure relief to these often larger entities than many smaller entities;

(c) the third category would not necessarily constitute a less onerous regime than the second category since entities in the third category would apply all the recognition and measurement requirements of all Australian equivalents to IFRSs, whereas the IASB's ED of A Proposed IFRS for SMEs proposes that SMEs apply certain recognition and measurement simplifications; and

(d) a third category is more appropriate to a regime which does not already exempt the smallest of entities.

Non-publicly accountable for-profit entities that are important from a public interest perspective

BC32 The AASB concluded that for-profit entities that do not satisfy the IASB's definition of a publicly accountable entity, but which are viewed as being important from a public interest perspective because of their large size, need to be treated like publicly accountable entities with regard to their financial reporting obligations. It would be in the public interest for such entities to apply the most rigorous and comprehensive reporting requirements in preparing general purpose financial reports. The AASB concluded that size thresholds should be proposed to identify this category of entities.

BC33 The IASB's ED of A Proposed IFRS for SMEs notes that a jurisdiction may decide that entities which are economically significant in that country should be required to use IFRSs rather than the IFRS for SMEs. Such jurisdictions may choose to define economic significance based on size thresholds.

BC34 The Corporations Act uses size thresholds to distinguish between large and small proprietary companies. However, the AASB considers it appropriate from a public interest perspective to use size thresholds to distinguish between for-profit entities that are not publicly accountable but should apply Australian equivalents to IFRSs and those that apply an Australian equivalent to the IFRS for SMEs. The AASB intends to set size thresholds at a level that only captures those that are so large that they attract high public interest. The AASB proposes the thresholds be set as a multiple of 20 of the monetary thresholds used to distinguish between large and small proprietary companies. Revised thresholds are included in The Simpler Regulatory System Bill that was introduced into the House of Representatives on 24 May 2007. It is intended that the monetary thresholds would change proportionally with any future change in the Corporations Act thresholds that distinguish large and small proprietary companies.

BC35 An entity may be important, but operate through a structure that is not compelled to make its financial reports available to the public at large. Such an entity would only be required to apply Australian equivalents to IFRSs if it chose to make its financial report available to the public at large. Whether such an entity should publish its

financial report is a matter of public policy and beyond the AASB's powers and jurisdiction.

Not-for-profit private sector entities

BC36 The AASB considers that there is public interest in the activities of many not-for-profit private sector entities on the grounds that such entities receive public funds or privileged access to public assets or enjoy tax concessions. For example, high public interest is expected in the activities of charities that either collect public money through the government or receive contributions directly from the public. Similarly, a professional body that levies tax deductible fees to members who provide key services to the public, and which acts in the public interest to regulate those members may attract public interest.

BC37 The AASB considers that the degree of public interest in these entities would be related to the impact of the entity's activities on the community, and such impact can reasonably be expected to be proportionate to the entity's size and volume of its activities. Accordingly, the AASB considers that the quantum of size thresholds would reasonably reflect the degree of public interest in the activities of these entities.

BC38 The AASB considers that the purpose of not-for-profit entities preparing financial reports is largely to discharge their duty of stewardship and accountability. However, there are small not-for-profit entities that often have simple structures and fewer users, where the costs of external reporting may be significant, and imposing significant reporting requirements is unlikely to be in the public interest. The AASB noted that, if all not-for-profit private sector entities were required to apply the Australian equivalents to IFRSs irrespective of their size and the degree of public interest in their activities, it may be unduly burdensome. The AASB concluded that a balance should be struck to help ensure that the cost of reporting by such entities would not exceed the benefits.

BC39 Accordingly, the AASB considered that it would be appropriate to use size thresholds to allow certain not-for-profit entities to apply an Australian equivalent to the IFRS for SMEs (which would include Aus paragraphs similar to those included in the Australian equivalents to IFRSs). The larger not-for-profit entities would apply the Australian equivalents to IFRSs. Other standard setters take a similar approach to distinguish reporting requirements for certain not-for-profit entities based on their size.

BC40 The AASB considered whether revenue should be the only size threshold in respect of not-for-profit entities on the grounds that it seems the most relevant indicator of a not-for-profit entity's significance from a public interest perspective. However, the AASB noted that there are not-for-profit entities that have substantial assets but low revenues. For these entities, a revenue test on its own would not suffice for classification purposes. Accordingly, the AASB concluded that size thresholds based on revenue and assets would be appropriate.

BC41 The AASB also considered whether the number of employees is an appropriate threshold to be applied in conjunction with revenue and assets thresholds. The Corporations Act uses three size thresholds of revenue, assets and number of employees to distinguish between large and small proprietary companies. The AASB considers that the employee number threshold would be difficult to apply in the not-for-profit private sector on the grounds that this sector draws to varying degrees on the

services of volunteers and that employee numbers may not adequately reflect the scale of a not-for-profit sector entity that uses volunteers. This makes the number of employees a potentially misleading basis for identifying the degree of public interest for distinguishing between the classes of entities within this sector applying different reporting requirements.

BC42 Some not-for-profit entities are established as companies limited by guarantee under the Corporations Act. These entities would be preparing general purpose financial reports, since those reports are lodged with the ASIC and are available for public use. These entities would be able to apply an Australian equivalent to the IFRS for SMEs if they fall below nominated size thresholds for not-for-profit entities.

BC43 Notwithstanding that an Australian equivalent to the IFRS for SMEs results in reduced reporting requirements in comparison with Australian equivalents to IFRSs, the AASB is aware that an Australian equivalent to the IFRS for SMEs could be burdensome for the smallest of not-for-profit entities that prepare general purpose financial reports, such as some companies limited by guarantee. The AASB also recognises though that the nature of some of these entities may give rise to specific accountabilities. As such the AASB encourages the Australian Government to consider the costs and benefits associated with these entities preparing general purpose financial reports to determine whether there is an opportunity to establish some form of exemption for these entities.

BC44 Any initiative by the Australian Government to exempt small companies limited by guarantee from preparing and filing would not, however, remove concerns about the reporting burden of the smallest of not-for-profit entities that prepare general purpose financial reports but are not established as companies limited by guarantee. The AASB will be consulting other authorities such as state governments about similar initiatives to provide relief to not-for-profit entities established under other laws and regulations.

BC45 In the event that small not-for-profit entities continue to be required to prepare financial reports, the AASB seeks comment on whether creating a third tier of simpler reporting requirements should be established to cater for these types of entities, assuming the IASB retains the existing levels of requirements in respect of its IFRS for SMEs.

Public sector entities

BC46 The AASB also notes that many public sector entities that fall under the proposed size thresholds are already applying Australian equivalents to IFRSs. Such entities would seem unlikely to choose to make another transition to an Australian equivalent to the IFRS for SMEs if they were to be allowed to apply the Standard under a revised reporting regime as this could be burdensome. There is also the likelihood that all public sector entities need to be consolidated at some stage into the financial statements of an entity (for example, a whole of government) that applies Australian equivalents to IFRSs. Even if a public sector entity adopted an Australian equivalent to the IFRS for SMEs, it would still need to operate financial reporting systems to collect the data required to be included in the consolidated financial statements that are prepared at the whole of government level in accordance with the Australian equivalents to IFRSs.

BC47 The AASB concluded, however, that it should provide the opportunity for smaller entities to apply less burdensome reporting requirements. It proposes size thresholds similar to those devised for not-for-profit private sector entities. Public sector entities falling below the thresholds would apply an Australian equivalent to the IFRS for SMEs, but could choose to apply Australian equivalents to IFRSs.

BC48 As in the case of not-for-profit private sector entities, the AASB also considered whether the number of employees is an appropriate threshold to be applied in conjunction with revenue and assets thresholds in the public sector. The AASB concluded that the employee number threshold is not particularly relevant and should not be used in the public sector.

BC49 The AASB considers that there is public interest in the financial activities of public sector entities on the grounds that those activities have significant impact on the economic and social life of the public. The public is also interested to know about the way public funds are used by an entity and to scrutinise the fund collecting function of an entity that has the ability to tax, rate or levy. The degree of public interest in the financial activities of a public sector entity is expected to vary with the degree of the entity's impact on public life. Accordingly, the AASB considers that differential reporting on the basis of size thresholds is warranted in the public sector on the grounds that the quantum of size thresholds would reasonably reflect the degree of public interest in the financial activities of public sector entities.

BC50 The AASB is aware that an Australian equivalent to the IFRS for SMEs could be burdensome for the smallest of public sector entities that prepare general purpose financial reports. Consequently, the AASB decided to seek comment on whether another tier of simpler reporting requirements should be established to cater for smaller public sector entities that prepare general purpose financial reports, assuming the IASB retains the proposed levels of requirements in respect of its IFRS for SMEs.

General purpose financial reports

BC51 The AASB considers that, in some cases, the concept of special purpose financial reports may have been misunderstood. Some entities should have prepared general purpose financial reports, rather than special purpose financial reports. The AASB has tentatively decided that all financial reports that are available on a public register, such as those prepared and lodged with the ASIC under the Corporations Act[10], would be regarded as general purpose financial reports. This clarification removes ambiguity and conforms the approach with the definition of a general purpose financial report in AASB 101 *Presentation of Financial Statements*. This equally applies to all financial reports that are otherwise made available to the public at large whether mandatorily or voluntarily. Accordingly, public sector entities that table annual reports in a Parliament containing an annual audited statutory financial report would be regarded as preparing general purpose financial reports.

BC52 The proposal to apply Australian Accounting Standards whenever an entity prepares general purpose financial reports has ramifications for some entities that prepare financial reports under the Corporations Act but are not required to lodge them. If

10 The AASB also notes that the size thresholds for proprietary companies preparing and lodging financial reports with the ASIC have been reviewed recently and are likely to be raised.

entities are required by the Corporations Act to prepare financial reports in accordance with Australian Accounting Standards, their financial reports would be regarded as general purpose financial reports and subject to Australian equivalents to IFRSs or an Australian equivalent to the IFRS for SMEs under the proposed differential reporting regime. An example would be proprietary companies that are exempted from lodging their financial reports under the grandfathering provision in section 1408(6) of the Corporations Act. Notwithstanding the relief from the requirement to lodge a financial report with the ASIC, if such an entity prepares a financial report in accordance with Australian Accounting Standards under the requirements of the Corporations Act, then its financial report would be regarded as a general purpose financial report.

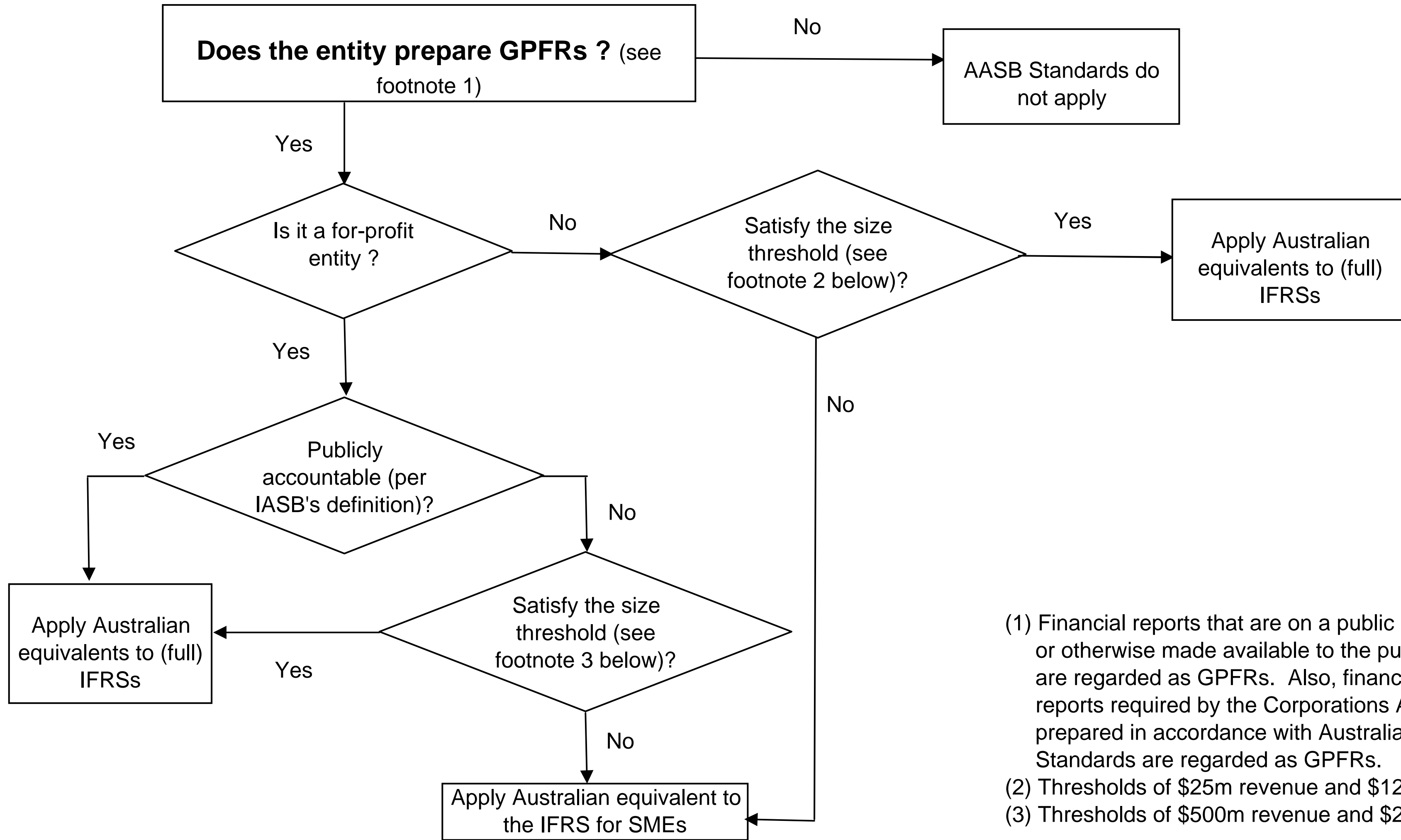
Amending the IASB's IFRS for SMEs

BC53 Consistent with its approach to adopting IFRSs into the Australian reporting framework, the AASB does not intend to modify the content of the IASB's IFRS for SMEs in respect of for-profit entities. Any modifications would result in lack of comparability with other jurisdictions that apply the IFRS for SMEs. In addition, adopting the IFRS for SMEs without modification in respect of for-profit entities would minimise the effort needed to maintain the Standard in Australia.

BC54 The IASB's IFRS for SMEs would need to be modified in the same way as the Australian equivalents to IFRSs are modified in their application to not-for-profit entities including public sector entities through suitable Aus paragraphs.

Appendix 1

Proposed Differential Reporting Regime- All Sectors



(1) Financial reports that are on a public register, or otherwise made available to the public at large are regarded as GPFRs. Also, financial reports required by the Corporations Act to be prepared in accordance with Australian Accounting Standards are regarded as GPFRs.
(2) Thresholds of $25m revenue and $12.5m assets.
(3) Thresholds of $500m revenue and $250m assets.

Exposure Draft
INTERNATIONAL FINANCIAL REPORTING STANDARD FOR SMALL AND MEDIUM-SIZED ENTITIES

Comments to be received by 1 October 2007

The Exposure Draft of the proposed *International Financial Reporting Standard for Small and Medium-sized Entities* is published by the International Accounting Standards Board (IASB) for comment only. The proposals may be modified in the light of the comments received before being issued as an International Financial Reporting Standard (IFRS). Comments on the draft standard and its accompanying documents should be sent in writing so as to be received by **1 October 2007**. Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org), using the 'Open to Comment' page.

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[DRAFT] INTERNATIONAL FINANCIAL REPORTING STANDARD FOR SMALL AND MEDIUM-SIZED ENTITIES (IFRS FOR SMEs)		
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BASIS FOR CONCLUSIONS *(see separate booklet)*

IMPLEMENTATION GUIDANCE:
ILLUSTRATIVE FINANCIAL STATEMENTS
AND DISCLOSURE CHECKLIST *(see separate booklet)*

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Invitation to Comment

The International Accounting Standards Board invites comments on any aspect of the Exposure Draft of its proposed *International Financial Reporting Standard for Small and Medium-sized Entities* (*IFRS for SMEs*). It would particularly welcome answers to the questions set out below. Comments are most helpful if they indicate the specific paragraph or group of paragraphs to which they relate, contain a clear rationale and, when applicable, provide a suggestion for alternative wording.

Comments should be submitted in writing so as to be received no later than **1 October 2007**.

Question 1 – Stand-alone document

In deciding on the content of the proposed IFRS for SMEs, the IASB focused on the types of transactions and other events and conditions typically encountered by SMEs with about 50 employees. For such entities, the proposed IFRS is intended to be a stand-alone document, with minimal cross-references to full IFRSs.

With the objective of a stand-alone document in mind, are there additional transactions, other events or conditions that should be covered in the proposed standard to make it more self-contained? Conversely, is there guidance in the draft standard that should be removed because it is unlikely to be relevant to typical SMEs with about 50 employees?

Question 2 – Recognition and measurement simplifications that the Board adopted

The draft *IFRS for SMEs* was developed by:

(a) extracting the fundamental concepts from the IASB *Framework* and the principles and related mandatory guidance from full IFRSs (including Interpretations), and

(b) considering the modifications that are appropriate in the light of users' needs and cost-benefit considerations.

Paragraphs BC70–BC93 of the Basis for Conclusions describe the simplifications of recognition and measurement principles contained in full IFRSs that have been made in the proposed *IFRS for SMEs* and explain the Board's reasoning.

Are there other recognition or measurement simplifications that the Board should consider? In responding, please indicate:

(a) the specific transactions, other events or conditions that create a specific recognition or measurement problem for SMEs under IFRSs;

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(b) why it is a problem; and

(c) how that problem might be solved.

Question 3 – Recognition and measurement simplifications that the Board considered but did not adopt

Paragraphs BC94–BC107 identify some recognition and measurement simplifications that the Board considered but decided not to adopt, for the reasons noted.

Should the Board reconsider any of those and, if so, why?

Question 4 – Whether all accounting policy options in full IFRSs should be available to SMEs

The draft *IFRS for SMEs* proposes that accounting policy options available under full IFRSs should generally also be available to SMEs. As explained more fully in paragraphs BC108–BC115 of the Basis for Conclusions, the Board concluded that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities following full IFRSs. At the same time, the Board recognised that most SMEs are likely to prefer the simpler option in the proposed *IFRS for SMEs*. Therefore, the Board concluded that in six circumstances in which full IFRSs allow accounting policy options, the *IFRS for SMEs* should include only the simpler option, and the other (more complex) option(s) should be available to SMEs by cross-reference to the full IFRSs.

Do you agree with the Board's conclusions on which options are the most appropriate for SMEs? If not, which one(s) would you change, and why?

Should any of these options that would be available to SMEs by cross-reference to the full IFRSs be eliminated from the draft *IFRS for SMEs* and, if so, why?

Question 5 – Borrowing costs

IAS 23 *Borrowing Costs* currently allows entities to choose either the expense model or the capitalisation model to account for all of their borrowing costs. In May 2006 the IASB published an Exposure Draft proposing to amend IAS 23 to prohibit the expense model and to require the capitalisation model. Section 24 *Borrowing Costs* of the draft *IFRS for SMEs* proposes to allow SMEs to choose either the expense model or the capitalisation model.

Do you agree or disagree with the proposal to allow SMEs to choose either the expense model or the capitalisation model for borrowing costs, and why?

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Question 6 – Topics not addressed in the proposed *IFRS for SMEs*

Some topics addressed in full IFRSs are omitted from the draft *IFRS for SMEs* because the Board believes that typical SMEs are not likely to encounter such transactions or conditions. These are discussed in paragraphs BC57–BC65 of the Basis for Conclusions. By a cross-reference, the draft standard requires SMEs that have such transactions to follow the relevant full IFRS.

Should any additional topics be omitted from the *IFRS for SMEs* and replaced by a cross-reference? If so, which ones and why?

Question 7 – General referral to full IFRSs

As noted in Question 1, the *IFRS for SMEs* is intended to be a stand-alone document for typical SMEs. It contains cross-references to particular full IFRSs in specific circumstances, including the accounting policy options referred to in Question 4 and the omitted topics referred to in Question 6. For other transactions, events or conditions not specifically addressed in the *IFRS for SMEs*, paragraphs 10.2–10.4 propose requirements for how the management of SMEs should decide on the appropriate accounting. Under those paragraphs, it is not mandatory for SMEs to look to full IFRSs for guidance.

Are the requirements in paragraphs 10.2–10.4, coupled with the explicit cross-references to particular IFRSs in specific circumstances, appropriate? Why or why not?

Question 8 – Adequacy of guidance

The draft *IFRS for SMEs* is accompanied by some implementation guidance, most notably a complete set of illustrative financial statements and a disclosure checklist. A sizeable amount of guidance that is in full IFRSs is not included. Accordingly, additional guidance especially tailored to the needs of SMEs applying the proposed IFRS may be required.

Are there specific areas for which SMEs are likely to need additional guidance? What are they, and why?

Question 9 – Adequacy of disclosures

Each section of the draft *IFRS for SMEs* includes disclosure requirements. Those requirements are summarised in the disclosure checklist that is part of the draft implementation guidance *Illustrative Financial Statements and Disclosure Checklist*.

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Are there disclosures that are not proposed that the Board should require for SMEs? If so, which ones and why? Conversely, do you believe that any of the proposed disclosures should not be required for SMEs? If so, which ones and why?

Question 10 – Transition guidance

Section 38 *Transition to the* IFRS for SMEs provides transition guidance for SMEs that move (a) from national GAAP to the *IFRS for SMEs* and (b) from full IFRSs to the *IFRS for SMEs*.

Do you believe that the guidance is adequate? If not, how can it be improved?

Question 11 – Maintenance of the *IFRS for SMEs*

The Board expects to publish an omnibus exposure draft of proposed amendments to the *IFRS for SMEs* approximately every other year. In developing such exposure drafts, the Board expects to consider new and amended IFRSs that have been adopted in the previous two years as well as specific issues that have been brought to its attention regarding possible amendments to the *IFRS for SMEs*. On occasion, the Board may identify a matter for which amendment of the *IFRS for SMEs* may need to be considered earlier than in the normal two-year cycle.

Is this approach to maintaining the proposed *IFRS for SMEs* appropriate, or should it be modified? If so, how and why?

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The [draft] *International Financial Reporting Standard for Small and Medium-sized Entities* (*IFRS for SMEs*) is set out in Sections 1–38, Appendix B to Section 11, and the Glossary. Terms defined in the Glossary are in **bold type** the first time they appear in each section. The [draft] *IFRS for SMEs* is accompanied by a Preface, Implementation Guidance and a Basis for Conclusions.

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Preface to the [draft] *IFRS for SMEs*

The IASB

P1 The International Accounting Standards Board (IASB) was established in 2001 as part of the International Accounting Standards Committee (IASC) Foundation.

P2 The objectives of the IASC Foundation and of the IASB are:

(a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;

(b) to promote the use and rigorous application of those standards;

(c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and

(d) to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.

P3 The governance of the IASC Foundation rests with 22 Trustees. The Trustees' responsibilities include appointing the members of the IASB and associated councils and committees, as well as securing financing for the organisation.

P4 The IASB is the standard-setting body of the IASC Foundation. The IASB comprises twelve full-time and two part-time members. The IASB is responsible for approving **International Financial Reporting Standards** (IFRSs) and related documents, such as the *Framework for the Preparation and Presentation of Financial Statements*, exposure drafts, discussion documents, and Interpretations of IFRSs. Before the IASB began operations, International Accounting Standards (IASs) and related Interpretations were established by the Board of IASC, which came into existence on 29 June 1973. By resolution of the IASB, IASs and related Interpretations remain applicable, with the same authority as IFRSs developed by the IASB, unless and until they are amended or withdrawn by the IASB.

International Financial Reporting Standards

P5 The IASB achieves its objectives primarily by developing and publishing IFRSs and promoting the use of those standards in **general purpose financial statements** and other financial reporting. Other financial reporting comprises information provided outside financial statements that assists in the interpretation of a complete set of financial statements or improves users' ability to make efficient economic decisions. The term 'financial reporting' encompasses general purpose financial statements plus other financial reporting.

P6 IFRSs set out recognition, measurement, presentation and disclosure requirements dealing with transactions and other events and conditions that are important in general purpose financial statements. They may also set out such requirements for transactions, events, and conditions that arise mainly in specific industries. IFRSs are based on the *Framework*, which addresses the concepts underlying the information presented in general purpose financial statements. The objective of the *Framework* is to facilitate the consistent and logical formulation of IFRSs. The *Framework* also provides a basis for the use of judgement in resolving accounting issues.

General purpose financial statements

P7 IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. General purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. The objective of financial statements is to provide information about the **financial position, performance** and **cash flows** of an entity that is useful to those users in making economic decisions.

P8 General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their particular information needs. General purpose financial statements include those that are presented separately or within another public document such as an annual report or a prospectus.

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The [draft] *IFRS for SMEs*

P9 The IASB also develops and publishes a separate standard intended to apply to the general purpose financial statements of, and other financial reporting by, entities that in many countries are known as **small and medium-sized entities** (SMEs). That standard is the [draft] *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*.

P10 The term SMEs as used by the IASB is defined in Section 1 *Scope* of the [draft] standard. Many jurisdictions around the world have developed their own definitions of the term for a broad range of purposes including prescribing financial reporting obligations. Often those national or regional definitions include quantified criteria based on revenue, assets, employees or other factors. Frequently, the term is used to mean or to include very small entities without regard to whether they publish general purpose financial statements for external users.

P11 SMEs often produce financial statements only for the use of owner-managers, or for tax reporting or other non-securities regulatory filing purposes. Financial statements produced solely for those purposes are not necessarily general purpose financial statements.

P12 Tax laws are specific to each jurisdiction, and the objectives of general purpose financial reports differ from the objectives of reporting taxable income. Thus, financial statements prepared in conformity with this [draft] standard are unlikely to comply fully with all of the measurements required for tax laws and regulations. Jurisdictions may be able to lessen the 'dual reporting burden' on SMEs by structuring tax reports as reconciliations from the profit or loss determined in accordance with the *IFRSs for SMEs* and by other means.

Authority of the [draft] *IFRS for SMEs*

P13 Decisions on which entities are required or permitted to use the IASB's standards rest with national regulatory authorities and standard-setters. This is true for full IFRSs and for the [draft] *IFRS for SMEs*. However, a clear definition of the class of entity for which the [draft] *IFRS for SMEs* is intended—as set out in Section 1 of the [draft] standard—is essential so that (a) the Board can decide on the standards that are appropriate for that class of entity and (b) national regulatory authorities, standard-setters, and reporting entities and their auditors will be informed of the

intended scope of applicability of the *IFRS for SMEs*. A clear definition is also essential so that entities that are not SMEs, and therefore are not eligible to use the [draft] standard, do not assert that they are in compliance with the *IFRS for SMEs* (see paragraph 1.3).

Organisation of the [draft] *IFRS for SMEs*

P14 The [draft] standard is organised by topic, with each topic presented in a separate numbered section. Cross-references to paragraphs are identified by section number followed by paragraph number. Cross-references to IFRSs are identified by the full name and number of the IFRS.

P15 All of the paragraphs in the [draft] standard have equal authority. Some sections include appendices of implementation guidance that are not part of the [draft] standard but, rather, are guidance for applying it.

Maintenance of the [draft] *IFRS for SMEs*

P16 The Board expects to propose amendments to the [draft] standard by publishing an omnibus exposure draft approximately every other year. In developing that exposure draft, the Board expects to consider new and amended IFRSs that have been adopted in the previous two years as well as specific issues that have been brought to its attention regarding possible amendments to the [proposed] *IFRS for SMEs*. On occasion, the Board may identify a matter for which amendment of the *IFRS for SMEs* may need to be considered earlier than in the normal two-year cycle. Until the *IFRS for SMEs* is amended, any changes that the IASB may make or propose with respect to full IFRSs do not apply to the *IFRS for SMEs*.

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[Draft] *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*

Section 1
Scope

1.1 The *IFRS for SMEs* is intended for use by **small and medium-sized entities** (SMEs). SMEs are entities that:

(a) do not have **public accountability**; and

(b) publish **general purpose financial statements** for external users. Examples of external users include owners who are not involved in managing the business, existing and potential creditors, and credit rating agencies.

1.2 An entity has public accountability if:

(a) it files, or it is in the process of filing, its **financial statements** with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity.

1.3 If a publicly accountable entity uses this [draft] standard, its financial statements shall not be described as conforming to the *IFRS for SMEs*—even if national law or regulation permits or requires this [draft] standard to be used by publicly accountable entities.

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Section 2
Concepts and Pervasive Principles

Objective of financial statements of SMEs

2.1 The **objective of financial statements** of a small or medium-sized entity is to provide information about the **financial position, performance** and **cash flows** of the entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs. In meeting that objective, financial statements also show the results of management's stewardship of the resources entrusted to it.

Qualitative characteristics of information in financial statements

Understandability

2.2 The information provided in financial statements should be presented in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence. However, the need for understandability does not allow relevant information to be omitted on the grounds that it may be too difficult for some users to understand.

Relevance

2.3 The information provided in financial statements must be relevant to the decision-making needs of users. Information has the quality of **relevance** when it influences the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

Materiality

2.4 Information is **material** if its omission or misstatement could influence the economic decisions of users made on the basis of the financial statements. Materiality depends on the size of the item or error judged in the particular circumstances of its omission or misstatement.

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However, it is inappropriate to make, or leave uncorrected, immaterial departures from the *IFRS for SMEs* to achieve a particular presentation of an entity's financial position, financial performance or cash flows.

Reliability

2.5 The information provided in financial statements must be **reliable**. Information is reliable when it is free from material error and bias and represents faithfully that which it either purports to represent or could reasonably be expected to represent. Financial statements are not free from bias if, by the selection or presentation of information, they are intended to influence the making of a decision or judgement in order to achieve a predetermined result or outcome.

Substance over form

2.6 Transactions and other events and conditions should be accounted for and presented in accordance with their substance and economic reality and not merely their legal form. This enhances the reliability of financial statements.

Prudence

2.7 The uncertainties that inevitably surround many events and circumstances are acknowledged by the disclosure of their nature and extent and by the exercise of **prudence** in the preparation of the financial statements. Prudence is the inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated. However, the exercise of prudence does not allow the deliberate understatement of assets or income, or the deliberate overstatement of liabilities or expenses. In short, prudence does not permit bias.

Completeness

2.8 To be reliable, the information in financial statements must be complete within the bounds of materiality and cost. An omission can cause information to be false or misleading and thus unreliable and deficient in terms of its relevance.

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Comparability

2.9 Users must be able to compare the financial statements of an entity through time in order to identify trends in its financial position and performance. Users must also be able to compare the financial statements of different entities in order to evaluate their relative financial position, performance and cash flows. Hence, the measurement and display of the financial effect of like transactions and other events and conditions must be carried out in a consistent way throughout an entity and over time for that entity and in a consistent way for different entities. In addition, users must be informed of the **accounting policies** employed in the preparation of the financial statements, and of any changes in those policies and the effects of such changes.

Timeliness

2.10 To be relevant, financial information must be able to influence the economic decisions of users. **Timeliness** involves providing the information within the decision time frame. If there is undue delay in the reporting of information it may lose its relevance. Management may need to balance the relative merits of timely reporting and the provision of reliable information. In achieving a balance between relevance and reliability, the overriding consideration is how best to satisfy the needs of users in making economic decisions.

Balance between benefit and cost

2.11 The benefits derived from information should exceed the cost of providing it. The evaluation of benefits and costs is substantially a judgemental process. Furthermore, the costs are not necessarily borne by those users who enjoy the benefits. In applying a costs and benefits test, an entity should understand that the benefits of the information may also be enjoyed by a broad range of external users.

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Financial position

2.12 The **financial position** of an entity is its assets, liabilities and equity at a point in time. The **elements of financial statements** directly related to the measurement of financial position are assets, liabilities and equity. These are defined as follows:

(a) An **asset** is a resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity.

(b) A **liability** is a present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

(c) **Equity** is the residual interest in the assets of the entity after deducting all its liabilities.

2.13 Some items that meet the definition of an asset or a liability may not be recognised as assets or liabilities in the balance sheet because they do not satisfy the criteria for **recognition** in paragraphs 2.24–2.29. In particular, the expectation that future economic benefits will flow to or from an entity must be sufficiently certain to meet the probability criterion before an asset or liability is recognised.

Assets

2.14 The future economic benefit of an asset is its potential to contribute, directly or indirectly, to the flow of cash and **cash equivalents** to the entity. Those cash flows may come from using the asset or from disposing of it.

2.15 Many assets, for example property, plant and equipment, have a physical form. However, physical form is not essential to the existence of an asset. Some assets are intangible.

2.16 In determining the existence of an asset, the right of ownership is not essential. Thus, for example, property held on a lease is an asset if the entity controls the benefits that are expected to flow from the property.

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Liabilities

2.17 An essential characteristic of a liability is that the entity has a present obligation to act or perform in a particular way. The obligation may be either a legal obligation or a **constructive obligation**. A legal obligation is legally enforceable as a consequence of a binding contract or statutory requirement. A constructive obligation is an obligation that derives from an entity's actions when:

(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 particular 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.

2.18 The settlement of a present obligation usually involves the payment of cash; transfer of other assets; provision of services; the replacement of that obligation with another obligation; or conversion of the obligation to equity. An obligation may also be extinguished by other means, such as a creditor waiving or forfeiting its rights.

Equity

2.19 Equity is the residual of recognised assets minus recognised liabilities. It may be subclassified in the balance sheet. For example, in a corporate entity, subclassifications may include funds contributed by shareholders, retained earnings and gains or losses reported directly in equity.

Performance

2.20 **Performance** is the relationship of the income and expenses of an entity as reported in its income statement. **Profit** is frequently used as a measure of performance or as the basis for other measures, such as return on investment or earnings per share. The elements of financial statements directly related to the measurement of profit are income and expenses. These are defined as follows:

(a) **Income** is increases in economic benefits during the **reporting period** in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

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(b) **Expenses** are decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

2.21 The recognition of income and expenses in the income statement results directly from the recognition and measurement of assets and liabilities. Criteria for the recognition of income and expenses are discussed in paragraphs 2.24–2.29.

Income

2.22 The definition of income encompasses both revenue and gains.

(a) **Revenue** is income that arises in the course of the ordinary activities of an entity and is referred to by a variety of names including sales, fees, interest, dividends, royalties and rent.

(b) **Gains** are other items that meet the definition of income but are not revenue. When gains are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for making economic decisions.

Expenses

2.23 The definition of expenses encompasses losses as well as those expenses that arise in the course of the ordinary activities of the entity.

(a) **Expenses** that arise in the course of the ordinary activities of the entity include, for example, cost of sales, wages and depreciation. They usually take the form of an outflow or depletion of assets such as cash and cash equivalents, inventory, property, plant and equipment.

(b) **Losses** are other items that meet the definition of expenses and may, or may not, arise in the course of the ordinary activities of the entity. When losses are recognised in the income statement, they are usually displayed separately because knowledge of them is useful for making economic decisions.

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Recognition of the elements of financial statements

2.24 Recognition is the process of incorporating in the balance sheet or income statement an item that meets the definition of an element and satisfies the following criteria:

(a) it is **probable** that any future economic benefit associated with the item will flow to or from the entity; and

(b) the item has a cost or value that can be measured reliably.

2.25 The failure to recognise an item that satisfies these criteria is not rectified by disclosure of the accounting policies used or by notes or explanatory material.

The probability of future economic benefit

2.26 The concept of probability is used in the recognition criteria to refer to the degree of uncertainty that the future economic benefits associated with the item will flow to or from the entity. Assessments of the degree of uncertainty attaching to the flow of future economic benefits are made on the basis of the evidence relating to conditions at the end of the reporting period available when the financial statements are prepared. Those assessments are made individually for individually significant items, and for a group for a large population of individually insignificant items.

Reliability of measurement

2.27 The second criterion for the recognition of an item is that it possesses a cost or value that can be measured with reliability. In many cases, the cost or value of an item is known. In other cases it must be estimated. The use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability. When a reasonable estimate cannot be made, the item is not recognised in the balance sheet or income statement.

2.28 An item that fails to meet the recognition criteria may qualify for recognition at a later date as a result of subsequent circumstances or events.

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2.29 An item that fails to meet the criteria for recognition may nonetheless warrant disclosure in the notes, explanatory material or in supplementary schedules. This is appropriate when knowledge of the item is relevant to the evaluation of the financial position, performance and changes in financial position of an entity by the users of financial statements.

Measurement of the elements of financial statements

2.30 **Measurement** is the process of determining the monetary amounts at which an entity measures assets, liabilities, income and expenses in its financial statements. Measurement involves the selection of a basis of measurement. This [draft] standard specifies which measurement basis an entity shall use for many types of assets, liabilities, income and expenses.

2.31 Two common measurement bases are historical cost and fair value:

(a) For assets, **historical cost** is the amount of cash or cash equivalents paid or the fair value of the consideration given to acquire the asset at the time of its acquisition. For liabilities, historical cost is the amount of proceeds of cash or cash equivalents received or the fair value of non-cash assets received in exchange for the obligation at the time the obligation is incurred.

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

Pervasive recognition and measurement principles

2.32 The requirements for recognising and measuring assets, liabilities, income and expenses in this [draft] standard are based on pervasive principles that are derived from the IASB *Framework for the Preparation and Presentation of Financial Statements*. In the absence of a requirement in this [draft] standard that applies specifically to a transaction or other event or condition including by cross-reference to a full **International Financial Reporting Standard (IFRS)**, paragraph 10.3 establishes a hierarchy for an entity to follow in deciding on the appropriate accounting policy in the circumstances. The second level of that hierarchy requires an entity to look to the pervasive recognition and measurement principles set out in paragraphs 2.33–2.43.

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Accrual basis

2.33 An entity shall prepare its financial statements, except for cash flow information, using the **accrual basis** of accounting. On the accrual basis, items are recognised as assets, liabilities, equity, income or expenses (the elements of financial statements) when they satisfy the definitions and recognition criteria for those elements.

Recognition in financial statements

Assets

2.34 An entity shall recognise an asset in the balance sheet when it is probable that the future economic benefits will flow to the entity and the asset has a cost or value that can be measured reliably. An asset is not recognised in the balance sheet when expenditure has been incurred for which it is considered improbable that economic benefits will flow to the entity beyond the current reporting period. Instead such a transaction results in the recognition of an expense in the income statement.

Liabilities

2.35 An entity shall recognise a liability in the balance sheet when it is probable that an outflow of resources embodying economic benefits will result from the settlement of a present obligation and the settlement amount can be measured reliably.

Income

2.36 The recognition of income results directly from the recognition of assets and liabilities. An entity shall recognise income in the income statement when an increase in future economic benefits related to an increase in an asset or a decrease of a liability has arisen that can be measured reliably.

Expenses

2.37 The recognition of expenses results directly from the recognition and measurement of assets and liabilities. An entity shall recognise expenses in the income statement when a decrease in future economic benefits related to a decrease in an asset or an increase of a liability has arisen that can be measured reliably.

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Profit or loss

2.38 Profit or loss is the arithmetical difference between income and expenses. It is not a separate element of financial statements, and a separate recognition principle is not needed for it.

2.39 This [draft] standard does not allow the recognition of items in the balance sheet that do not meet the definition of assets or of liabilities regardless of whether they result from applying the notion commonly referred to as the 'matching concept'.

Measurement at initial recognition

2.40 At initial recognition, an entity shall measure assets and liabilities at historical cost unless this [draft] standard requires initial measurement on another basis such as fair value.

Subsequent measurement

Financial assets and financial liabilities

2.41 After initial recognition, an entity generally measures **financial assets** and **financial liabilities** at fair value unless this [draft] standard requires or permits measurement on another basis such as cost or amortised cost.

Non-financial assets

2.42 Most non-financial assets that an entity initially recognised at historical cost are subsequently measured on other measurement bases. For example, an entity measures **property, plant and equipment** at the lower of depreciated cost and fair value less costs to sell, and measures inventories at the lower of cost and selling price less costs to complete and sell. Measurement of assets at those lower amounts is intended to ensure that an asset is not measured at an amount greater than the entity expects to recover from the sale or use of that asset.

2.43 For some non-financial assets that an entity initially recognised at historical cost, this [draft] standard permits or requires subsequent measurement at fair value. Examples include:

(a) investments in **associates** and **joint ventures** that an entity measures at fair value (see paragraphs 13.6 and 14.12 respectively);

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(b) **investment property** that an entity measures at fair value (see paragraph 15.5);

(c) property, plant and equipment that an entity measures at revalued amount (see paragraph 16.13);

(d) **intangible assets** that an entity measures at revalued amount (see paragraph 17.23); and

(e) agricultural assets (**biological assets** and **agricultural produce** at the point of harvest) that an entity measures at fair value less estimated costs to sell (see paragraph 35.1).

Liabilities other than financial liabilities

2.44 Most liabilities other than financial liabilities are measured at the best estimate of the amount that would be required to settle the obligation at the **reporting date**.

Offsetting

2.45 An entity shall not offset assets and liabilities, or income and expenses, unless required or permitted by this [draft] standard.

(a) Measuring assets net of valuation allowances—for example, allowances for inventory obsolescence and allowances for uncollectible receivables—is not offsetting.

(b) If an entity's normal operating activities do not include buying and selling non-current assets, including investments and operating assets, then the entity reports gains and losses on disposal of such assets by deducting from the proceeds on disposal the **carrying amount** of the asset and related selling expenses.

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Section 3
Financial Statement Presentation

Fair presentation

3.1 **Financial statements** shall present fairly the **financial position**, financial **performance** and **cash flows** of an entity. **Fair presentation** requires the faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and **recognition** criteria for assets, liabilities, income and expenses set out in Section 2 *Concepts and Pervasive Principles*.

(a) The application of this [draft] standard by SMEs, with additional disclosure when necessary, is presumed to result in financial statements that achieve a fair presentation of the financial position, financial performance and cash flows of SMEs.

(b) As explained in paragraph 1.3, the application of this [draft] standard by an entity with public accountability does not result in a fair presentation in accordance with this [draft] standard.

The additional disclosures referred to in (a) are necessary when compliance with the specific requirements in this [draft] standard is insufficient to enable users to understand the effect of particular transactions, other events and conditions on the entity's financial position and financial performance.

Compliance with the [draft] *IFRS for SMEs*

3.2 An entity whose financial statements comply with the [draft] *IFRS for SMEs* shall make an explicit and unreserved statement of such compliance in the notes. Financial statements shall not be described as complying with the *IFRS for SMEs* unless they comply with all the requirements of this [draft] standard.

3.3 In the extremely rare circumstances in which management concludes that compliance with this [draft] standard would be so misleading that it would conflict with the **objective of financial statements** of SMEs set out in Section 2, the entity shall depart from that requirement in the manner set out in paragraph 3.4 if the relevant regulatory framework requires, or otherwise does not prohibit, such a departure.

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3.4 When an entity departs from a requirement of this [draft] standard in accordance with paragraph 3.3, it shall disclose:

(a) that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows;

(b) that it has complied with the *IFRS for SMEs*, except that it has departed from a particular requirement to achieve a fair presentation;

(c) the nature of the departure, including the treatment that the *IFRS for SMEs* would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in Section 2, and the treatment adopted; and

(d) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

3.5 When an entity has departed from a requirement of this [draft] standard in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures set out in paragraph 3.4(c) and (d).

3.6 In the extremely rare circumstances in which management concludes that compliance with a requirement in this [draft] standard would be so misleading that it would conflict with the objective of financial statements of SMEs set out in Section 2, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing:

(a) the nature of the requirement in this [draft] standard, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in Section 2; and

(b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.

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Going concern

3.7 When preparing financial statements, the management of an entity using this [draft] standard shall make an assessment of the entity's ability to continue as a **going concern**. An entity is a going concern unless management either intends to liquidate the entity or to cease operations, or has no realistic alternative but to do so. When management is aware, in making its assessment, of **material** uncertainties related to events or conditions that may cast significant doubt upon the entity's ability to continue as a going concern, the entity shall disclose those uncertainties. When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Frequency of reporting

3.8 An entity shall present a complete set of financial statements (including comparative information) at least annually. When the end of an entity's **reporting period** changes and the annual financial statements are presented for a period longer or shorter than one year, the entity shall disclose:

(a) that fact;

(b) the reason for using a longer or shorter period; and

(c) the fact that comparative amounts for the **income statement, statement of changes in equity, statement of income and retained earnings**, **cash flow statement** and related **notes** are not entirely comparable.

Consistency of presentation

3.9 An entity shall retain the presentation and classification of items in the financial statements from one period to the next unless:

(a) it is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation or classification would be more appropriate having regard to the criteria for the selection and application of **accounting policies** in Section 10 *Accounting Policies, Estimates and Errors*; or

(b) this [draft] standard requires a change in presentation.

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3.10 When the presentation or classification of items in the financial statements is changed, an entity shall reclassify comparative amounts unless the reclassification is **impracticable**. When comparative amounts are reclassified, an entity shall disclose:

(a) the nature of the reclassification;

(b) the amount of each item or class of items that is reclassified; and

(c) the reason for the reclassification.

3.11 When it is impracticable to reclassify comparative amounts, an entity shall disclose:

(a) the reason for not reclassifying the amounts; and

(b) the nature of the adjustments that would have been made if the amounts had been reclassified.

Comparative information

3.12 Except when this [draft] standard permits or requires otherwise, an entity shall disclose comparative information in respect of the previous comparable period for all amounts reported in the financial statements (including the information on the face of the financial statements and in the notes). An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Materiality and aggregation

3.13 An entity shall present separately each material class of similar items. An entity shall present separately items of a dissimilar nature or function unless they are immaterial.

3.14 Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users 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 size or nature of the item, or a combination of both, could be the determining factor.

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Complete set of financial statements

3.15 The financial statements of an entity shall include:

(a) a **balance sheet**;

(b) an income statement;

(c) a statement of changes in **equity** showing either:

(i) all changes in equity; or

(ii) changes in equity other than those arising from transactions with equity holders acting in their capacity as equity holders;

(d) a cash flow statement; and

(e) notes, comprising a summary of significant accounting policies and other explanatory information.

3.16 If the only changes to the equity of an entity during the periods for which financial statements are presented arise from profit or loss, payment of dividends, corrections of prior period **errors**, and changes in accounting policy, the entity may present a statement of income and retained earnings in place of the income statement and statement of changes in equity.

3.17 Because paragraph 3.12 requires comparative amounts in respect of the previous period for all amounts reported in the financial statements (whether on the face of the financial statements or in the notes), a complete set of financial statements means that an entity shall present, as a minimum, two of each of the required financial statements and related notes.

3.18 In a complete set of financial statements, an entity shall present each financial statement with equal prominence.

3.19 An entity may use titles for the financial statements other than those used in this [draft] standard as long as they are not misleading.

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Identification of the financial statements

3.20 An entity shall clearly identify each of the financial statements and the notes and distinguish them from other information in the same document. In addition, an entity shall display the following information prominently, and repeat it when necessary for an understanding of the information presented:

(a) the name of the reporting entity and any change in its name since the end of the preceding reporting period;

(b) whether the financial statements cover the individual entity or a group of entities;

(c) the date of the end of the reporting period and the period covered by the financial statements;

(d) the presentation currency, as defined in Section 30 *Foreign Currency Translation*; and

(e) the level of rounding, if any, used in presenting amounts in the financial statements.

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Section 4
Balance Sheet

Purpose

4.1 The **balance sheet** presents an entity's **assets, liabilities** and **equity** at a point in time.

Information to be presented on the face of the balance sheet

4.2 As a minimum, an entity shall include, on the face of the balance sheet, line items that present the following amounts:

(a) cash and **cash equivalents**;

(b) trade and other receivables;

(c) **financial assets** (excluding amounts shown under (a), (b) and (h));

(d) **inventories**;

(e) **property, plant and equipment**;

(f) **intangible assets**;

(g) **biological assets**;

(h) investments accounted for using the equity method;

(i) the total of non-current assets classified as **held for sale** and assets included in **disposal groups** classified as held for sale in accordance with Section 36 *Discontinued Operations and Assets Held for Sale*;

(j) trade and other payables;

(k) **financial liabilities** (excluding amounts shown under (j) and (o));

(l) liabilities and assets for **current tax**;

(m) **deferred tax liabilities** and **deferred tax assets** (these shall always be classified as non-current);

(n) liabilities included in disposal groups classified as held for sale.

(o) **provisions**;

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(p) **minority interest**, presented within **equity** separately from the **parent** shareholders' equity; and

(q) equity attributable to shareholders of the parent.

4.3 An entity shall present additional line items, headings and subtotals on the face of the balance sheet when such presentation is relevant to an understanding of the entity's **financial position**.

4.4 This [draft] standard does not prescribe the sequence or format in which items are to be presented.

Current/non-current distinction

4.5 An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its balance sheet in accordance with paragraphs 4.6–4.9, except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, all assets and liabilities shall be presented in order of approximate liquidity.

Current assets

4.6 An entity shall classify an asset as current when:

(a) it expects to realise the asset, or intends to sell or consume it, in the entity's normal operating cycle;

(b) it holds the asset primarily for the purpose of trading;

(c) it expects to realise the asset within twelve months after the end of the **reporting period**; or

(d) the asset is cash or a cash equivalent, unless it is restricted from being exchanged or used to settle a liability for at least twelve months after the end of the reporting period.

4.7 An entity shall classify all other assets as non-current. When the entity's normal operating cycle is not clearly identifiable, its duration is assumed to be twelve months.

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Current liabilities

4.8 An entity shall classify a liability as current when:

(a) it expects to settle the liability in the entity's normal operating cycle;

(b) it holds the liability primarily for the purpose of trading;

(c) the liability is due to be settled within twelve months after the end of the reporting period; or

(d) the entity does not have an unconditional right to defer settlement of the liability for at least twelve months after the end of the reporting period.

4.9 An entity shall classify all other liabilities as non-current.

Sequencing of items and format of items on the balance sheet

4.10 This [draft] standard does not prescribe the sequence or format in which items are to be presented. Paragraph 4.2 simply provides a list of items that are sufficiently different in nature or function to warrant separate presentation on the face of the balance sheet. In addition:

(a) line items are included when the size, nature or function of an item or aggregation of similar items is such that separate presentation is relevant to an understanding of the entity's financial position; and

(b) the descriptions used and the ordering of items or aggregation of similar items may be amended according to the nature of the entity and its transactions, to provide information that is relevant to an understanding of the entity's financial position.

4.11 The judgement on whether additional items are presented separately is based on an assessment of:

(a) the nature and liquidity of assets;

(b) the function of assets within the entity; and

(c) the amounts, nature and timing of liabilities.

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Information to be presented either on the face of the balance sheet or in the notes

4.12 An entity shall disclose, either on the face of the balance sheet or in the notes, the following subclassifications of the line items presented:

(a) classes of items of property, plant and equipment in accordance with Section 16 *Property, Plant and Equipment*;

(b) amounts receivable from trade customers, receivables from **related parties**, prepayments and other amounts;

(c) classes of inventories in accordance with Section 12 *Inventories*, such as merchandise, production supplies, materials, work in progress and finished goods;

(d) provisions for **employee benefits** and other provisions; and

(e) classes of equity, such as paid-in capital, share premium, retained earnings and items of income and expense that, as required by this [draft] standard, are recognised directly in equity.

4.13 An entity with share capital shall disclose the following, either on the face of the balance sheet or in the notes:

(a) for each class of share capital:

(i) the number of shares authorised;

(ii) the number of shares issued and fully paid, and issued but not fully paid;

(iii) par value per share, or that the shares have no par value;

(iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the period (see paragraph 21.12 for further guidance);

(v) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;

(vi) shares in the entity held by the entity or by its subsidiaries or associates;

(vii) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts; and

(b) a description of each reserve within equity.

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4.14 An entity without share capital, such as a partnership or trust, shall disclose information equivalent to that required by paragraph 4.13(a), showing changes during the period in each category of equity, and the rights, preferences and restrictions attaching to each category of equity.

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Section 5
Income Statement

Purpose

5.1 The **income statement** presents the **income** and **expenses** of an entity for a period.

5.2 The income statement shall include all items of income and expense recognised in a period unless this [draft] standard requires otherwise. This [draft] standard provides different treatment for the following:

(a) the effects of corrections of errors and changes in **accounting policies** are presented as adjustments of prior periods rather than as part of profit or loss in the period in which they arise (see Section 10 *Accounting Policies, Estimates and Errors*); and

(b) revaluation surpluses (see Section 16 *Property, Plant and Equipment*), some **gains** and **losses** arising on translating the **financial statements** of a foreign operation (see Section 30 *Foreign Currency Translation*), and some changes in **fair values** of hedging instruments (see Section 11 *Financial Assets and Financial Liabilities*) are reported directly in **equity**, rather than as part of profit or loss, when they arise.

Information to be presented on the face of the income statement

5.3 As a minimum, an entity shall include, on the face of the income statement, line items that present the following amounts for the period:

(a) **revenue**;

(b) finance costs;

(c) share of the profit or loss of investments in **associates** and **joint ventures** accounted for using the equity method;

(d) **tax expense**;

(e) a single amount comprising the total of (i) the post-tax profit or loss of **discontinued operations** and (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on

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the disposal of the assets or **disposal group(s)** constituting the discontinued operation (see Section 36 *Discontinued Operations and Assets Held for Sale*); and

(f) profit or loss.

5.4 An entity shall disclose separately the following items on the face of the income statement as allocations of profit or loss for the period:

(a) profit or loss attributable to **minority interest**; and

(b) profit or loss attributable to equity holders of the parent.

5.5 An entity shall present additional line items, headings and subtotals on the face of the income statement when such presentation is relevant to an understanding of the entity's financial **performance**.

5.6 An entity shall not present or describe any items of income and expense as 'extraordinary items', either on the face of the income statement or in the notes.

Information to be presented either on the face of the income statement or in the notes

5.7 An entity shall disclose separately the nature and amount of **material** components of income and expense. Such disclosures shall include:

(a) write-downs of inventories to selling price less costs to complete and sell, and the reversal of such write-downs;

(b) write-downs of **property, plant and equipment** to fair value less costs to sell, and the reversal of such write-downs;

(c) restructurings of the activities of an entity and reversals of any **provisions** for the costs of restructuring;

(d) disposals of items of property, plant and equipment;

(e) disposals of investments;

(f) **discontinued operations**;

(g) litigation settlements; and

(h) the reversal of other provisions.

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Analysis of expenses

5.9 An entity shall present an analysis of expenses using a classification based on either the nature of expenses or the function of expenses within the entity, whichever provides information that is reliable and more relevant.

Analysis by nature of expense

(a) Under this method of classification, expenses are aggregated in the income statement according to their nature (for example, depreciation, purchases of materials, transport costs, employee benefits and advertising costs), and are not reallocated among various functions within the entity.

Analysis by function of expense

(b) Under this method of classification, expenses are aggregated according to their function as part of cost of sales or, for example, the costs of distribution or administrative activities. At a minimum, an entity discloses its cost of sales under this method separately from other expenses.

5.10 Entities are encouraged to present this analysis on the face of the income statement. The illustrative financial statements that accompany this [draft] standard include examples of both types of presentation.

5.11 Entities classifying expenses by function shall disclose additional information on the nature of expenses, including **depreciation** and **amortisation** expense and **employee benefits** expense.

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Section 6
Statement of Changes in Equity and Statement of Income and Retained Earnings

Statement of changes in equity

Purpose

6.1 The **statement of changes in equity** presents an entity's profit or loss for a period, items of income and expense recognised directly in **equity** for the period, the effects of changes in **accounting policies** and corrections of errors recognised in the period, and (depending on the format of the statement of changes in equity chosen by the entity) the amounts of investments by, and dividends and other distributions to, equity holders during the period.

Information to be presented on the face of the statement of changes in equity

6.2 An entity shall present a statement of changes in equity showing on the face of the statement:

(a) profit or loss for the period;

(b) each item of income and expense for the period that, as required by this [draft] standard, is recognised directly in equity, and the total of those items;

(c) total income and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to equity holders of the parent and to **minority interest**; and

(d) for each component of equity, the effects of changes in accounting policies and corrections of **errors** recognised in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

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Information to be presented either on the face of the statement of changes in equity or in the notes

6.3 An entity shall also present, either on the face of the statement of changes in equity or in the notes:

(a) the amounts of investments by, and dividends and other distributions to, equity holders, showing separately issues of shares, treasury share transactions, and dividends and other distributions to equity holders;

(b) the balance of retained earnings (ie accumulated profit or loss) at the beginning of the **reporting period** and at the end of the period, and the changes during the period; and

(c) a reconciliation of the **carrying amount** of each class of contributed equity and each item of income and expense recognised directly in equity (see paragraph 6.2(b)) at the beginning and the end of the period, separately disclosing each change.

Statement of income and retained earnings

Purpose

6.4 The **statement of income and retained earnings** presents an entity's profit or loss and changes in retained earnings for a reporting period. Paragraph 3.16 of this [draft] standard permits an entity to present a statement of income and retained earnings in place of the income statement and statement of changes in equity if the only changes to its equity during the period arise from profit or loss, payment of dividends, corrections of prior period errors, and changes in accounting policy.

Information to be presented on the face of the statement of income and retained earnings

6.5 An entity shall present, on the face of the statement of income and retained earnings, the following items in addition to the information required by Section 5 *Income Statement*:

(a) retained earnings at the beginning of the reporting period;

(b) dividends declared and paid or payable during the period;

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(c) restatements of retained earnings for corrections of prior period errors;

(d) restatements of retained earnings for changes in accounting policy; and

(e) retained earnings at the end of the reporting period.

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Section 7
Cash Flow Statement

Purpose

7.1 The **cash flow statement** provides information about the historical changes in **cash** and **cash equivalents** of an entity, showing separately changes during the period from operating, investing and financing activities.

7.2 Cash equivalents are held to meet short-term cash commitments rather than for investment or other purposes. 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. Bank overdrafts are normally considered financing activities similar to borrowings. However, if they are repayable on demand and form an integral part of an entity's cash management, bank overdrafts are a component of cash and cash equivalents.

Content

7.3 An entity shall present a cash flow statement that reports **cash flows** for a period classified by **operating activities**, **investing activities** and **financing activities**.

Operating activities

7.4 Cash flows from operating activities are primarily derived from the principal **revenue**-producing activities of the entity. Therefore, they generally result from the transactions and other events and conditions that enter into the determination of profit or loss. Examples of cash flows from operating activities are:

(a) cash receipts from the sale of goods and the rendering of services;

(b) cash receipts from royalties, fees, commissions and other revenue;

(c) cash payments to suppliers for goods and services;

(d) cash payments to and on behalf of employees;

(e) cash payments or refunds of income taxes, unless they can be specifically identified with financing and investing activities; and

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(f) cash receipts and payments from investments, loans, and other contracts held for dealing or trading purposes, which are similar to inventory acquired specifically for resale.

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

Investing activities

7.5 Cash flows arising from investing activities represent expenditures made for resources intended to generate future income and cash flows. Examples of cash flows arising from investing activities are:

(a) cash payments to acquire property, plant and equipment (including self-constructed property, plant and equipment), intangible assets (including capitalised development costs), and other long-term assets;

(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 classified as cash equivalents or held for dealing or trading);

(d) cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments classified as cash equivalents or held for dealing or trading);

(e) cash advances and loans made to other parties;

(f) cash receipts from the repayment of advances and loans made to other parties;

(g) cash payments for futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading, 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, or the receipts are classified as financing activities.

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When a contract is accounted for as a hedge (see Section 11 *Financial Assets and Financial Liabilities*), an entity shall classify the cash flows of the contract in the same manner as the cash flows of the item being hedged.

Financing activities

7.6 Examples of cash flows arising from financing activities are:

(a) cash proceeds from issuing shares or other equity instruments;

(b) cash payments to owners to acquire or redeem the entity's shares;

(c) cash proceeds from issuing debentures, loans, notes, bonds, mortgages and other short-term or long-term borrowings;

(d) cash repayments of amounts borrowed; and

(e) cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease.

Reporting cash flows from operating activities

7.7 An entity shall report cash flows from operating activities using either:

(a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or

(b) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

7.8 Under the indirect method, the net cash flow from operating activities is determined by adjusting profit or loss for the effects of:

(a) changes during the period in inventories and operating receivables and payables;

(b) non-cash items such as **depreciation, provisions, deferred taxes**, unrealised foreign currency gains and losses, undistributed profits of **associates**, and **minority interests**; and

(c) all other items for which the cash effects relate to investing or financing.

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Alternatively, the net cash flow from operating activities may be presented under the indirect method by showing the revenues and expenses disclosed in the income statement and the changes during the period in inventories and operating receivables and payables.

7.9 An entity choosing to use the direct method shall apply paragraphs 18–20 of IAS 7 *Cash Flow Statements*.

Reporting cash flows from investing and financing activities

7.10 An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units shall be presented separately and classified as operating activities.

Foreign currency cash flows

7.11 An entity shall record cash flows arising from transactions in a foreign currency in the entity's functional currency by applying to the foreign currency amount the exchange rate between the functional currency and the foreign currency at the date of the cash flow.

7.12 The entity shall translate cash flows of a foreign subsidiary at the exchange rates between the functional currency and the foreign currency at the dates of the cash flows.

7.13 Unrealised gains and losses arising from changes in foreign currency exchange rates are not cash flows. However, to reconcile cash and cash equivalents at the beginning and the end of the period, the effect of exchange rate changes on cash and cash equivalents held or due in a foreign currency must be reported in the cash flow statement. Therefore, the entity shall remeasure cash and cash equivalents held during the period at period-end exchange rates. The entity shall present the resulting unrealised gain or loss separately from cash flows from operating, investing and financing activities.

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Interest and dividends

7.14 An entity shall disclose separately cash flows from interest and dividends received and paid (interest paid includes amount capitalised under the **accounting policy** choice in Section 24 *Borrowing Costs*). The entity shall classify cash flows consistently from period to period as operating, investing or financing activities.

7.15 An entity may classify interest paid and interest and dividends received as operating cash flows because they are included in profit or loss. Alternatively, the entity may classify interest paid and interest and dividends received as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

7.16 An entity may classify dividends paid as a financing cash flow because they are a cost of obtaining financial resources. Alternatively, the entity may classify dividends paid as a component of cash flows from operating activities because they are paid out of operating cash flows.

Taxes on income

7.17 An entity shall disclose separately cash flows arising from taxes on income and shall classify them as cash flows from operating activities unless they can be specifically identified with financing and investing activities. When tax cash flows are allocated over more than one class of activity, the entity shall disclose the total amount of taxes paid.

Non-cash transactions

7.18 An entity shall exclude from the cash flow statement investing and financing transactions that do not require the use of cash or cash equivalents. An entity shall disclose such transactions elsewhere in the **financial statements** in a way that provides all the relevant information about these investing and financing activities.

7.19 Many investing and financing activities do not have a direct impact on current cash flows although they affect the capital and asset structure of an entity. The exclusion of non-cash transactions from the cash flow statement is consistent with the objective of a cash flow statement

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because these items do not involve cash flows in the current period. Examples of non-cash transactions are:

(a) the acquisition of assets either by assuming directly related liabilities or by means of a finance lease;

(b) the acquisition of an entity by means of an equity issue; and

(c) the conversion of debt to equity.

Components of cash and cash equivalents

7.20 An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts reported in the cash flow statement to the equivalent items reported in the balance sheet.

Other disclosures

7.21 An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity. Cash and cash equivalents held by an entity may not be available for use by the entity because of, among other reasons, foreign exchange controls or legal restrictions.

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Section 8
Notes to the Financial Statements

Purpose

8.1 **Notes** contain information in addition to that presented on the face of the **financial statements**. Notes provide narrative descriptions or disaggregations of items presented in those statements and information about items that do not qualify for **recognition** in those statements.

Structure

8.2 The notes shall:

(a) present information about the basis of preparation of the financial statements and the specific **accounting policies** used, in accordance with paragraphs 8.5 and 8.6;

(b) disclose the information required by this [draft] standard that is not presented on the face of the financial statements; and

(c) provide additional information that is not presented on the face of the financial statements but is relevant to an understanding of them.

8.3 An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each item on the face of the financial statements to any related information in the notes.

8.4 An entity normally presents the notes in the following order:

(a) a statement that the financial statements have been prepared in compliance with the *IFRS for SMEs* (see paragraph 3.2);

(b) a summary of significant accounting policies applied (see paragraph 8.5);

(c) supporting information for items presented on the face of the financial statements, in the order in which each statement and each line item is presented; and

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(d) other disclosures, including:

(i) **contingent liabilities** and **contingent assets** (see Section 20 *Provisions and Contingencies*) and unrecognised contractual commitments;

(ii) non-financial disclosures;

(iii) the amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to **equity** holders during the period, and the related amount per share; and

(iv) the amount of any cumulative preference dividends not recognised.

Disclosure of accounting policies

8.5 An entity shall disclose in the summary of significant accounting policies:

(a) the measurement basis (or bases) used in preparing the financial statements;

(b) the accounting policy the entity has chosen whenever the entity has adopted an accounting policy for an event, a transaction, other event or condition for which this [draft] standard allows an accounting policy choice; and

(c) the other accounting policies used that are relevant to an understanding of the financial statements.

Information about judgements

8.6 An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 8.7), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

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Information about key sources of estimation uncertainty

8.7 An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the **reporting period**, that have a significant risk of causing a **material** adjustment to the **carrying amounts** of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of:

(a) their nature; and

(b) their carrying amount as at the end of the reporting period.

Information about externally imposed capital requirements

8.8 If an entity is subject to externally imposed capital requirements, it shall disclose the nature of those requirements and how they are managed, including whether the requirements have been complied with.

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Section 9
Consolidated and Separate Financial Statements

Control

9.1 Except as permitted by paragraph 9.2, a **parent** entity shall present **consolidated financial statements** in which it consolidates its investments in **subsidiaries** in accordance with this [draft] standard. Consolidated financial statements shall include all subsidiaries of the parent.

9.2 A parent need not present consolidated financial statements if:

(a) the parent is itself a subsidiary; and

(b) its ultimate parent (or any intermediate parent) produces consolidated **general purpose financial statements** that comply with full **International Financial Reporting Standards** or with this [draft] standard.

9.3 A subsidiary is an entity that is controlled by the parent. **Control** is the power to govern the financial and operating policies of an entity so as to obtain benefits from its activities. If an entity has created a special purpose entity (SPE) to accomplish a narrow and well-defined objective, the entity shall consolidate the SPE when the substance of the relationship indicates that the SPE is controlled by that entity.

9.4 Control is presumed to exist when the parent owns, directly or indirectly through subsidiaries, more than half of the voting power of an entity unless, in exceptional circumstances, it can be clearly demonstrated that such ownership does not constitute control. Control also exists when the parent owns half or less of the voting power of an entity but it has:

(a) power over more than half of the voting rights by virtue of an agreement with other investors;

(b) power to govern the financial and operating policies of the entity under a statute or an agreement;

(c) power to appoint or remove the majority of the members of the board of directors or equivalent governing body and control of the entity is by that board or body; or

(d) power to cast the majority of votes at meetings of the board of directors or equivalent governing body and control of the entity is by that board or body.

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9.5 A subsidiary is not excluded from consolidation simply because the investor is a venture capital organisation or similar entity.

9.6 A subsidiary is not excluded from consolidation because its business activities are dissimilar from those of the other entities within the consolidation. Relevant information is provided by consolidating such subsidiaries and disclosing additional information in the consolidated financial statements about the different business activities of subsidiaries.

9.7 A subsidiary is not excluded from consolidation because it operates in a jurisdiction that imposes restrictions on transferring cash or other assets out of the jurisdiction.

Consolidation procedures

9.8 The consolidated financial statements present financial information about the group as a single economic entity. In preparing consolidated financial statements, an entity shall:

(a) combine the financial statements of the parent and its subsidiaries line by line by adding together like items of assets, liabilities, equity, income and expenses;

(b) eliminate the **carrying amount** of the parent's investment in each subsidiary and the parent's portion of equity of each subsidiary;

(c) measure **minority interests** in the profit or loss of consolidated subsidiaries for the **reporting period** separately from the parent shareholders' interest; and

(d) measure minority interests in the net assets of consolidated subsidiaries separately from the parent shareholders' equity in them. Minority interests in the net assets consist of:

(i) the amount of those minority interests at the date of the original combination; and

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

Potential voting rights

9.9 When potential voting rights exist (such as voting rights that would result from exercise of share options or warrants or from conversion of convertible securities), the proportions of profit or loss and changes in

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equity allocated to the parent and minority interests are determined on the basis of existing ownership interests and do not reflect the possible exercise or conversion of potential voting rights.

Intragroup balances and transactions

9.10 Intragroup balances and transactions, including income, expenses and dividends, are eliminated in full. Profits and losses resulting from intragroup transactions that are recognised in assets, such as inventory and fixed assets, are eliminated in full. Intragroup losses may indicate an impairment that requires **recognition** in the consolidated financial statements. Section 28 *Income Taxes* applies to temporary differences that arise from the elimination of profits and losses resulting from intragroup transactions.

Uniform reporting date

9.11 The financial statements of the parent and its subsidiaries used in the preparation of the consolidated financial statements shall be prepared as of the same **reporting date** unless it is **impracticable** to do so.

Uniform accounting policies

9.12 Consolidated financial statements shall be prepared using uniform **accounting policies** for like transactions and other events and conditions in similar circumstances. If a member of the group uses accounting policies other than those adopted in the consolidated financial statements for like transactions and events in similar circumstances, appropriate adjustments are made to its financial statements in preparing the consolidated financial statements.

Acquisition and disposal of subsidiaries

9.13 The income and expenses of a subsidiary are included in the consolidated financial statements from the acquisition date. The income and expenses of a subsidiary are included in the consolidated financial statements until the date on which the parent ceases to control the subsidiary. The difference between the proceeds from the disposal of the subsidiary and its carrying amount as of the date of disposal, including the cumulative amount of any exchange differences that relate to the subsidiary recognised in equity in accordance with Section 30 *Foreign Currency Translation*, is recognised in the consolidated income statement as the gain or loss on the disposal of the subsidiary.

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9.14 If an entity ceases to be a subsidiary but the investor (former parent) continues to hold some equity shares, those shares shall be accounted for as a **financial asset** in accordance with Section 11 *Financial Assets and Financial Liabilities* from the date the entity ceases to be a subsidiary, provided that it does not become an **associate** or a **jointly controlled entity**. The carrying amount of the investment at the date that the entity ceases to be a subsidiary shall be regarded as the cost on initial measurement of a financial asset.

Minority interests in subsidiaries

9.15 An entity shall present minority interest in the consolidated balance sheet within equity, separately from the parent shareholders' equity, as required by paragraph 4.2(p).

9.16 An entity shall disclose minority interest in the profit or loss of the group separately in the income statement, as required by paragraph 5.4.

9.17 Losses applicable to the minority in a consolidated subsidiary may exceed the minority interest in the subsidiary's equity. The excess, and any further losses applicable to the minority, are allocated against the majority interest except to the extent that the minority has a binding obligation and is able to make an additional investment to cover the losses. If the subsidiary subsequently reports profits, such profits are allocated to the majority interest until the minority's share of losses previously absorbed by the majority has been recovered.

Separate financial statements

9.18 Paragraph 9.1 requires a parent to prepare consolidated financial statements. This [draft] standard does not require a parent to produce **separate financial statements** for the parent entity or for the individual subsidiaries. When separate financial statements of a parent are prepared, the entity shall adopt a policy of accounting for all of its investments in subsidiaries, **jointly controlled entities** and **associates** that are not classified as held for sale either:

(a) at cost, or

(b) at **fair value** through profit or loss.

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9.19 When a parent, a venturer with an interest in a jointly controlled entity or an investor in an associate prepares separate financial statements, those separate financial statements shall disclose:

(a) that the statements are separate financial statements and the reasons why those statements are prepared if not required by law;

(b) a list of significant investments in subsidiaries, jointly controlled entities and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; and

(c) a description of the method used to account for the investments listed under (b);

and shall identify the consolidated financial statements to which they relate.

9.20 The financial statements of an entity that does not have a subsidiary, associate or venturer's interest in a jointly controlled entity are not separate financial statements.

Combined financial statements

9.21 **Combined financial statements** are a single set of financial statements of two or more entities controlled by a single investor. This [draft] standard does not require combined financial statements to be prepared. The controlling investor may prepare combined financial statements because the affiliated entities have common objectives and economic interests and are managed jointly.

9.22 If an entity prepares combined financial statements and describes them as conforming to the *IFRS for SMEs*, those statements shall comply with all of the requirements of this [draft] standard. Intercompany transactions and balances shall be eliminated; profits or losses resulting from intercompany transactions that are recognised in assets such as inventory and fixed assets shall be eliminated; the financial statements of the entities included in the combined financial statements shall be prepared as of the same reporting date unless it is impracticable to do so; and uniform accounting policies shall be followed for like transactions and other events in similar circumstances. Disclosures shall include the fact that the financial statements are combined financial statements and the **related party** disclosures required by Section 33 *Related Party Disclosures*.

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Section 10
Accounting Policies, Estimates and Errors

Selection and application of accounting policies

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

10.2 If this [draft] standard does not specifically address a transaction, other event or condition, management shall use its judgement in developing and applying an accounting policy that results in information that is:

(a) **relevant** to the economic decision-making needs of users; and

(b) **reliable**, in that the financial statements:

(i) represent faithfully the **financial position**, financial **performance** and **cash flows** of the entity;

(ii) reflect the economic substance of transactions, other events and conditions, and not merely the legal form;

(iii) are neutral, ie free from bias;

(iv) are prudent; and

(v) are complete in all **material** respects.

10.3 In making the judgement described in paragraph 10.2, management shall refer to, and consider the applicability of, the following sources in descending order:

(a) the requirements and guidance in this [draft] standard dealing with similar and related issues; and

(b) the definitions, **recognition** criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles*.

10.4 In making the judgement described in paragraph 10.2, management may also consider the requirements and guidance in full **International Financial Reporting Standards (IFRSs)** dealing with similar and related issues. If additional guidance is needed to make the judgement described in paragraph 10.2, management may also consider the most

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recent pronouncements of other standard-setting bodies that use a similar conceptual framework to develop accounting standards, other accounting literature and accepted industry practices, to the extent that these do not conflict with the sources in paragraph 10.3.

Consistency of accounting policies

10.5 An entity shall select and apply its accounting policies consistently for similar transactions, other events and conditions, unless this [draft] standard specifically requires or permits categorisation of items for which different policies may be appropriate. If this [draft] standard requires or permits such categorisation, an appropriate accounting policy shall be selected and applied consistently to each category.

Changes in accounting policies

10.6 An entity shall change an accounting policy only if the change:

(a) is required by changes to this [draft] standard; or

(b) results in the financial statements providing reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash flows.

10.7 The following are not changes in accounting policies:

(a) the application of an accounting policy for transactions, other events or conditions that differ in substance from those previously occurring; and

(b) the application of a new accounting policy for transactions, other events or conditions that did not occur previously or were not material.

10.8 If this [draft] standard allows a choice of accounting treatment for a specified transaction or other event or condition, and an entity changes its choice, that is a change in accounting policy. Similarly, a change of measurement basis is a change in accounting policy.

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Applying changes in accounting policies

10.9 An entity shall account for changes in accounting policy as follows:

(a) an entity shall account for a change in accounting policy resulting from a change in the requirements of this [draft] standard in accordance with the transitional provisions, if any, specified in that amendment;

(b) when this [draft] standard requires or permits an entity to follow the requirements of a full IFRS, and the requirements of that IFRS change, the entity shall account for that change in accounting policy in accordance with the transitional provisions, if any, specified in that IFRS; and

(c) an entity shall account for all other changes in accounting policy **retrospectively**.

Retrospective application

10.10 When a change in accounting policy is applied retrospectively in accordance with paragraph 10.9, the entity applies the new accounting policy to comparative information for prior periods as far back as is practicable, as if the new accounting policy had always been applied. When it is **impracticable** to determine the individual period effects of changing an accounting policy for one or more prior periods presented, the entity shall adjust the opening balance of each affected component of equity for the earliest prior period for which retrospective application is practicable, which may be the current period, and shall make a corresponding adjustment to the opening balance of each affected component of equity for that period.

Disclosure of a change in accounting policy

10.11 When initial application of this [draft] standard, or an amendment to this [draft] standard, has an effect on the current period or any prior period or might have an effect on future periods, an entity shall disclose:

(a) the nature of the change in accounting policy;

(b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected; and

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(c) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(d) an explanation if it is impracticable to determine the amounts to be disclosed in (b) or (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

10.12 When a voluntary change in accounting policy has an effect on the current period or any prior period, or might have an effect on future periods, an entity shall disclose:

(a) the nature of the change in accounting policy;

(b) the reasons why applying the new accounting policy provides reliable and more relevant information;

(c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected;

(d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and

(e) an explanation if it is impracticable to determine the amounts to be disclosed in (c) or (d) above.

Financial statements of subsequent periods need not repeat these disclosures.

Changes in accounting estimates

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

10.14 An entity shall recognise the effect of a change in an accounting estimate, other than a change to which paragraph 10.15 applies, **prospectively** by including it in profit or loss in:

(a) the period of the change, if the change affects that period only; or

(b) the period of the change and future periods, if the change affects both.

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10.15 To the extent that a change in an accounting estimate gives rise to changes in assets and liabilities, or relates to an item of equity, the entity shall recognise it by adjusting the carrying amount of the related asset, liability or equity item in the period of the change.

Disclosure of a change in estimate

10.16 An entity shall disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods, except for the disclosure of the effect on future periods when it is impracticable to estimate that effect.

10.17 If the amount of the effect in future periods is not disclosed because estimating it is impracticable, an entity shall disclose that fact.

Corrections of prior period errors

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

(a) was available when financial statements for those periods were authorised 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.

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

10.20 To the extent practicable, an entity shall correct a prior period error retrospectively in the first financial statements authorised for issue after its discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred; or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

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10.21 When it is impracticable to determine the period-specific effects of an error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).

10.22 When it is impracticable to restate any prior periods, the entity shall recognise the effect of the error in opening retained earnings of the current period.

Disclosure of prior period errors

10.23 An entity shall disclose the following about prior period errors:

(a) the nature of the prior period error;

(b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected;

(c) the amount of the correction at the beginning of the earliest prior period presented; and

(d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected.

Financial statements of subsequent periods need not repeat these disclosures.

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Section 11
Financial Assets and Financial Liabilities

Accounting policy choice

11.1 An entity shall choose to apply either:

(a) the provisions of this section, or

(b) IAS 39 *Financial Instruments: Recognition and Measurement*

in full to account for all of its financial instruments. An entity that chooses to apply IAS 39 shall make the disclosures required by IFRS 7 *Financial Instruments: Disclosures*. An entity's choice of (a) or (b) is an **accounting policy** choice. Paragraphs 10.6–10.12 of Section 10 *Accounting Policies, Estimates and Errors* contain requirements for determining when a change in accounting policy is appropriate, how such a change should be accounted for, and what information should be disclosed about the change in accounting policy.

Scope

11.2 A **financial instrument** is a contract that gives rise to a **financial asset** of one entity and a **financial liability** or equity instrument of another entity. Common examples include:

(a) cash;

(b) demand and fixed-term deposits;

(c) commercial paper and commercial bills;

(d) accounts, notes, and loans receivable and payable;

(e) bonds and similar debt instruments;

(f) ordinary and preferred shares and similar equity instruments;

(g) asset-backed securities such as collateralised mortgage obligations, repurchase agreements, and securitised packages of receivables; and

(h) options, rights, warrants, futures contracts, forward contracts, and interest rate swaps that can be settled in cash or by exchanging another financial instrument.

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11.3 This section applies to all financial instruments except the following:

(a) interests in **subsidiaries** (covered by Section 9 *Consolidated and Separate Financial Statements*), **associates** (see Section 13 *Investments in Associates*) and **joint ventures** (see Section 14 *Investments in Joint Ventures*);

(b) employers' rights and obligations under employee benefit plans (see Section 27 *Employee Benefits*);

(c) rights under insurance contracts unless the insurance contract could result in a loss to either party as a result of contractual terms that are unrelated to:

(i) changes in the insured risk,

(ii) changes in foreign exchange rates, or

(iii) a default by one of the counterparties;

(d) financial instruments that meet the definition of an entity's own equity (see Sections 21 *Equity* and 25 *Share-based Payment*); and

(e) leases (see Section 19 *Leases*) unless the lease could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to:

(i) changes in the price of the leased asset,

(ii) changes in foreign exchange rates, or

(iii) a default by one of the counterparties.

11.4 Most contracts to buy or sell a non-financial item such as a commodity, inventory, property, plant or equipment are excluded from this section because they are not financial instruments. However, this section applies to all contracts that could result in a loss to the buyer or seller as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties.

11.5 In addition to the contracts described in paragraph 11.4, this section applies to contracts to buy or sell non-financial items if the contract can be settled net in cash or another financial instrument, or by exchanging financial instruments, as if the contracts were financial instruments, with the following exception: contracts that were entered into and

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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 are not financial instruments for the purposes of this section.

Initial recognition of financial assets and liabilities

11.6 An entity shall recognise a financial asset or a financial liability only when the entity becomes a party to the contractual provisions of the instrument.

Measurement

11.7 At each **reporting date**, an entity shall measure the following financial instruments at cost or amortised cost less impairment, as indicated:

(a) an instrument (such as a receivable, payable, or loan) that meets the conditions of paragraph 11.9, and that the entity designates at initial **recognition** to be measured at amortised cost (using the **effective interest method**) less impairment. Appendix A to this section provides guidance on applying the effective interest method.

(b) a commitment to make or receive a loan that:

(i) cannot be settled net in cash,

(ii) when executed, is expected to meet the conditions for recognition at cost or amortised cost less impairment, and

(iii) the entity designates at initial recognition to be measured at cost less impairment.

(c) equity instruments that are not **publicly traded** and whose **fair value** cannot otherwise be measured reliably, and contracts linked to such instruments that, if exercised, will result in delivery of such instruments, which shall be measured at cost less impairment.

11.8 With the exception of those financial instruments measured at cost or amortised cost less impairment in accordance with paragraph 11.7, at each reporting date an entity shall measure all financial instruments at fair value, without any deduction for transaction costs it may incur on sale or other disposal, and recognise changes in fair value recognised in profit or loss.

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11.9 An entity may designate an instrument for measurement at amortised cost, in accordance with paragraph 11.7(a), only if it meets all of the following conditions:

(a) It has a specified maturity date or is due on demand and, at or before the specified maturity date, it requires repayment of all or substantially all of the amount of consideration received or paid when it was issued.

(b) Returns to the holder are

(i) a fixed amount,

(ii) a fixed rate of return over the life of the instrument,

(iii) a variable return that, throughout the life of the instrument, is equal to a single referenced quoted or observable interest rate (such as LIBOR) or

(iv) some combination of these fixed rate and variable rates (such as LIBOR plus 200 basis points). For fixed and variable rate interest returns, interest is calculated by multiplying the rate for the applicable period by the principal outstanding during the period.

(c) There is no contractual provision that could result in the holder losing the principal amount and any interest attributable to the current period or prior periods.

(d) Contractual provisions that permit the issuer to prepay the debt or permit the holder to put it back to the issuer before maturity are not contingent on future events. The instrument may require the party exercising an early settlement right to make a penalty payment as long as the penalty is a fixed amount, a specified percentage of the invested amount or principal amount outstanding at the date of exercise, or an amount based on a change in an interest rate that reduces the benefit that otherwise would be obtained by the party exercising the settlement right.

(e) There are no conditional returns or repayment provisions except for the variable rate return described in (b) and prepayment provisions described in (d).

For the purpose of applying these conditions to the debt component of a **compound financial instrument**, an entity first separates the equity component as required by paragraph 21.7 of Section 21 *Equity*.

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11.10 Examples of financial instruments that would be, or could be designated to be, measured at cost or amortised cost less impairment are:

(a) normal trade accounts and notes receivable and payable and loans from banks or other third parties, because these typically satisfy the conditions in paragraph 11.9.

(b) investments in non-convertible debt instruments, because these typically satisfy the conditions in paragraph 11.9.

(c) a contract or right (option) to buy an equity instrument whose fair value cannot be reliably measured if the contract or right will result in the delivery of the equity instrument, because that equity instrument is measured at cost less impairment in accordance with paragraph 11.7(c).

(d) accounts payable in a foreign currency, because the contractual cash flows typically satisfy the conditions in paragraph 11.9. However, any change in the account payable because of a change in the exchange rate is recognised in profit or loss as required by paragraph 30.10 of Section 30 *Foreign Currency Translation*.

(e) loans to or from subsidiaries or associates that are due on demand, because they typically satisfy the conditions in paragraph 11.9.

(f) a debt instrument that would become immediately receivable if the issuer defaults on an interest or principal payment (such a provision does not violate the conditions in paragraph 11.9).

11.11 Examples of financial instruments that are not measured at cost or amortised cost less impairment are as follows. They are measured at fair value through profit or loss (see paragraph 11.8):

(a) investments in equity instruments with published price quotations, because paragraph 11.7(c) allows measurement at cost less impairment only for equity instruments that are not publicly traded and whose fair value cannot otherwise be measured reliably.

(b) an interest rate swap that returns a cash flow that is positive or negative, or a forward commitment to purchase a commodity or financial instrument that is capable of being cash-settled and that, on settlement, could have positive or negative cash flow, because such swaps and forwards do not meet the condition in paragraph 11.9(b).

(c) options and forward contracts, because returns to the holder are not fixed and the condition in paragraph 11.9(b) is not met.

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(d) investments in convertible debt, because the return to the holder can vary with the price of the debt issuer's equity shares rather than just with market interest rates.

(e) perpetual debt, because it does not have a maturity date as required by paragraph 11.9(a).

11.12 An entity shall not change its policy for the subsequent measurement of a financial asset or liability into or out of the fair value through profit or loss category while it is held or issued.

11.13 If a reliable measure of fair value is no longer available for an equity instrument measured at fair value through profit or loss, its fair value **carrying amount** at the date of the change becomes its new cost. The entity shall measure the instrument at this cost amount less impairment until a reliable measure of fair value becomes available.

Fair value

11.14 Paragraph 11.8 requires some financial instruments to be measured at fair value. The best evidence of fair value is a quoted price in an active market. If the market for a financial instrument is not active, an entity estimates fair value by using a valuation technique. The objective of using a valuation technique is to estimate what the transaction price would have been on the measurement date in an arm's length exchange motivated by normal business considerations.

11.15 The fair value of a financial liability with a demand feature (eg 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.

11.16 An entity shall not include transaction costs in the initial measurement of financial assets and liabilities measured at fair value through profit or loss. If payment for the asset is deferred or is financed at a rate of interest that is not a market rate, the entity shall measure cost at the **present value** of the future payments discounted at a market rate of interest.

11.17 An entity shall apply the additional guidance on estimating the fair value of a financial asset or a financial liability that is provided in Appendix B to this section.

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Impairment of financial instruments measured at cost or amortised cost

Recognition

11.18 At the end of each **reporting period**, an entity shall assess for impairment all financial assets that are measured at cost or amortised cost. If there is objective evidence of impairment, the entity shall recognise an **impairment loss** in profit or loss. Financial instruments measured at fair value through profit or loss are not specially assessed for impairment because the fair valuation process automatically recognises any impairment.

11.19 Objective evidence that a financial asset or group of assets is impaired includes observable data that come 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 creditor, for economic or legal reasons relating to the debtor's financial difficulty, granting to the debtor a concession that the creditor would not otherwise consider;

(d) it has become **probable** that the debtor will enter bankruptcy or other financial reorganisation;

(e) the disappearance of an active market for that financial asset because of the debtor's 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, even though the decrease cannot yet be identified with the individual financial assets in the group, such as adverse national or local economic conditions or adverse changes in industry conditions.

11.20 Other factors may also be evidence of impairment, including significant changes with an adverse effect that have taken place in the technological, market, economic or legal environment in which the issuer operates.

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11.21 Financial assets that are individually significant, and all equity instruments regardless of significance, shall be assessed individually for impairment. Other financial assets shall be assessed for impairment either individually or grouped on the basis of similar credit risk characteristics.

Measurement

11.22 An entity shall measure an impairment loss as follows:

(a) for an instrument measured at amortised cost less impairment in accordance with paragraph 11.7(a), the impairment loss is the difference between the asset's carrying amount and the present value of estimated cash flows discounted at the financial asset's original effective interest rate; and

(b) for an instrument measured at cost less impairment in accordance with paragraph 11.7(b) and (c), the impairment loss is the difference between the asset's carrying amount and the asset's fair value.

Reversal

11.23 If, in a subsequent period, the amount of an impairment loss decreases and the decrease can be related objectively to an event occurring after the impairment was recognised (such as an improvement in the debtor's credit rating), the entity shall reverse the previously recognised impairment loss either directly or by adjusting an allowance account. The reversal shall not result in a carrying amount of the financial asset (net of any allowance account) that exceeds what the carrying amount would have been had the impairment not previously been recognised. The entity shall recognise the amount of the reversal in profit or loss.

Derecognition of a financial asset

11.24 An entity shall **derecognise** a financial asset only when:

(a) the contractual rights to the cash flows from the financial asset expire or are settled;

(b) the entity transfers to another party all of the significant risks and rewards relating to the financial asset; or

(c) the entity, despite having retained some significant risks and rewards relating to the financial asset, has transferred control of the asset to another party and the other party has the practical

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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. In this case, the entity shall:

(i) derecognise the asset, and

(ii) recognise separately any rights and obligations created or retained in the transfer.

The carrying amount of the transferred asset shall be allocated between the rights or obligations retained and those transferred based on their relative fair values at the transfer date. Newly created rights and obligations shall be measured at their fair values at that date. Any difference between the consideration received and the amounts recognised and derecognised in accordance with this paragraph shall be recognised in profit or loss in the period of the transfer.

11.25 If a transfer does not result in derecognition because the entity has retained significant risks and rewards of ownership of the transferred asset, the entity shall continue to recognise the transferred asset in its entirety and shall recognise a financial liability for the consideration received. The asset and liability shall not be offset. In subsequent periods, the entity shall recognise any income on the transferred asset and any expense incurred on the financial liability.

11.26 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, the transferor shall reclassify that asset in its balance sheet (eg 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 recognise 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 derecognise the collateral, and the transferee shall recognise the collateral as its

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asset initially measured at fair value or, if it has already sold the collateral, derecognise 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 recognise the collateral as an asset.

Derecognition of a financial liability

11.27 An entity shall derecognise a financial liability (or a part of a financial liability) only when it is extinguished—ie when the obligation specified in the contract is discharged or cancelled or expires.

11.28 If an existing borrower and lender exchange debt instruments with substantially different terms, the entities shall account for the transaction as an extinguishment of the original financial liability and the recognition of a new financial liability. Similarly, an entity shall account for 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) as an extinguishment of the original financial liability and the recognition of a new financial liability. The entity shall recognise in profit or loss any 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.

Hedge accounting

11.29 An entity may designate a hedging relationship between a **hedging instrument** and a **hedged item** in such a way as to qualify for hedge accounting. If specified criteria are met, hedge accounting permits the gain or loss on the hedging instrument and on the hedged item to be recognised in profit or loss at the same time.

11.30 To qualify for hedge accounting, an entity shall comply with all of the following conditions:

(a) the entity designates and documents the hedging relationship so that the risk being hedged, the hedged item and the hedging instrument are clearly identified and the risk in the hedged item is the risk being hedged with the hedging instrument.

(b) the hedged risk is one of the risks specified in paragraph 11.31.

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(c) the hedging instrument is as specified in paragraph 11.32.

(d) the entity expects the hedging instrument to be highly effective in offsetting the designated hedged risk. The **effectiveness of a hedge** 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.

11.31 This [draft] standard permits hedge accounting only for:

(a) interest rate risk of a debt instrument measured at amortised cost;

(b) foreign exchange or interest rate risk in a firm commitment or a **highly probable forecast transaction**;

(c) price risk of a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity; or

(d) foreign exchange risk in a net investment in a foreign operation.

11.32 This [draft] standard permits hedge accounting only if the hedging instrument has all of following terms and conditions:

(a) it is an interest rate swap, a foreign currency swap, a foreign currency forward exchange contract or a commodity forward exchange contract that is expected to be highly effective in offsetting a risk identified in paragraph 11.31 that is designated as being the hedged risk.

(b) it involves a party external to the reporting entity (ie external to the group, segment or individual entity being reported on).

(c) its **notional amount** is equal to the designated amount of the principal or notional amount of the hedged item.

(d) it has a specified maturity date not later than

(i) the maturity of the financial instrument being hedged,

(ii) the expected settlement of the commodity purchase commitment, or

(iii) the occurrence of the highly probable forecast foreign currency or commodity transaction being hedged.

(e) it has no prepayment, early termination or extension features.

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Hedge of fixed interest rate risk of a recognised financial instrument or commodity price risk of a commodity held

11.33 If the conditions in paragraph 11.30 are met and the hedged risk is the exposure to a fixed interest rate risk of a debt instrument measured at amortised cost or the commodity price risk of a commodity that it holds, the entity shall:

(a) recognise the hedging instrument as an asset or liability and the change in the fair value of the hedging instrument in profit or loss; and

(b) recognise the change in the fair value of the hedged item related to the hedged risk in profit or loss and as an adjustment to the carrying amount of the hedged item.

11.34 If the hedged risk is the fixed interest rate risk of a debt instrument measured at amortised cost, the entity shall recognise the periodic net cash settlements on the interest rate swap that is the hedging instrument in profit or loss in the period in which the net settlements accrue.

11.35 The entity shall discontinue the hedge accounting specified in paragraph 11.33 if:

(a) the hedging instrument expires or is sold or terminated;

(b) the hedge no longer meets the conditions for hedge accounting specified in paragraph 11.30; or

(c) the entity revokes the designation.

11.36 If hedge accounting is discontinued and the hedged item is an asset or liability carried at amortised cost that has not been derecognised, any gains or losses recognised as adjustments to the carrying amount of the hedged item are amortised into profit or loss using the effective interest method over the remaining life of the hedged instrument.

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Hedge of variable interest rate risk of a recognised financial instrument, foreign exchange risk or commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation

11.37 If the conditions in paragraph 11.30 are met and the hedged risk is

(a) the variable interest rate risk in a debt instrument measured at amortised cost,

(b) the foreign exchange risk in a **firm commitment** or a highly probable forecast transaction,

(c) the commodity price risk in a firm commitment or highly probable forecast transaction, or

(d) the foreign exchange risk in a net investment in a foreign operation,

the entity shall recognise directly in equity the portion of the change in the fair value of the hedging instrument that was effective in offsetting the change in the fair value or expected cash flows of the hedged item. The entity shall recognise any excess of the fair value of the hedging instrument over the change in the fair value of the expected cash flows in profit or loss. The hedging relationship ends for (a), (b) and (c) when the hedged transaction occurs and for (d) when the net investment in the foreign operation is sold. The hedging gain or loss recognised in equity shall be reclassified to profit and loss when the hedged item is recognised in profit and loss.

11.38 If the hedged risk is the variable interest rate risk in a debt instrument measured at amortised cost, the entity shall subsequently recognise the periodic net cash settlements from the interest rate swap that is the hedging instrument in profit or loss in the period in which the net settlements accrue.

11.39 The entity shall discontinue the hedge accounting specified in paragraph 11.37 or 11.38 if:

(a) the hedging instrument expires or is sold or terminated;

(b) the hedge no longer meets the criteria for hedge accounting in paragraph 11.30;

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(c) in a hedge of a forecast transaction, the forecast transaction is no longer highly probable; or

(d) the entity revokes the designation.

If the forecast transaction is no longer expected to take place or if the hedged debt instrument measured at amortised cost is derecognised, any gain or loss on the hedging instrument that was recognised directly in equity shall be removed from equity and recognised in profit or loss.

Disclosure

Disclosure of accounting policies for financial instruments

11.40 In accordance with paragraph 8.5 of Section 8 *Notes to the Financial Statements*, an entity shall disclose, in the summary of significant accounting policies, the measurement basis (or bases) used for financial instruments and the other accounting policies used for financial instruments that are relevant to an understanding of the financial statements.

Balance sheet—categories of financial assets and financial liabilities

11.41 An entity shall disclose the carrying amounts of each of the following categories of financial assets and financial liabilities, in total and by each significant type of financial asset or financial liability within each category, either on the face of the balance sheet or in the notes:

(a) financial assets measured at fair value through profit or loss (paragraph 11.8);

(b) financial assets measured at amortised cost less impairment (paragraph 11.7(a));

(c) equity instruments measured at cost (paragraph 11.7(c));

(d) loan commitments measured at cost less impairment (paragraph 11.7(b));

(e) financial liabilities measured at fair value through profit or loss (paragraph 11.8); and

(f) financial liabilities measured at amortised cost (paragraph 11.7(a)).

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11.42 For all financial assets and financial liabilities measured at fair value, the entity shall disclose the basis for determining fair value, eg quoted market price in an active market or a valuation technique. When a valuation technique is used, the entity shall disclose 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.

11.43 If a reliable measure of fair value is no longer available for an equity instrument measured at fair value through profit or loss, the entity shall disclose that fact.

Derecognition

11.44 If an entity has transferred financial assets to another party in a transaction that does not qualify for derecognition (see paragraphs 11.24–11.26), 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; and

(c) the carrying amounts of the assets and of any associated liabilities that the entity continues to recognise.

Collateral

11.45 When an entity has pledged financial assets as collateral for liabilities or contingent liabilities, it shall disclose:

(a) the carrying amount of the financial assets pledged as collateral; and

(b) the terms and conditions relating to its pledge.

Defaults and breaches on loans payable

11.46 For loans payable recognised at the reporting date, an entity shall disclose:

(a) details of any defaults during the period of principal, interest, sinking fund, or redemption terms of those loans payable that permit the lender to demand repayment at the reporting date;

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(b) the carrying amount of the loans payable in default at the reporting date; and

(c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.

11.47 If, during the period, there were breaches of loan agreement terms other than those described in paragraph 11.46, an entity shall disclose the same information as is required by paragraph 11.46 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 reporting date).

Income statement and equity—items of income, expense, gains or losses

11.48 An entity shall disclose the following items of income, expense, gains or losses either on the face of the financial statements or in the notes:

(a) net gains or net losses recognised on:

(i) financial assets measured at fair value through profit or loss;

(ii) financial liabilities measured at fair value through profit or loss;

(iii) financial assets measured at amortised cost less impairment; and

(iv) financial liabilities measured at amortised cost;

(b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss; and

(c) the amount of any impairment loss for each class of financial asset.

Hedge accounting

11.49 An entity shall disclose the following separately for hedges of each of the four types of risks described in paragraph 11.31:

(a) a description of the hedge;

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(b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date; and

(c) the nature of the risks being hedged, including a description of the hedged item.

11.50 For a hedge of fixed interest rate risk or commodity price risk of a commodity held (paragraphs 11.33–11.36) the entity shall disclose:

(a) the amount of the change in fair value of the hedging instrument recognised in profit or loss and

(b) the amount of the change in fair value of the hedged item recognised in profit or loss.

11.51 For a hedge of variable interest rate risk, foreign exchange risk, commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation (paragraphs 11.37–11.39) the entity shall disclose:

(a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss;

(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 of the change in fair value of the hedging instrument that was recognised in equity during the period (paragraph 11.37);

(d) the amount that was removed from equity and recognised in profit or loss for the period, showing the amount included in each line item in the income statement (paragraphs 11.38 and 11.39).

Risks relating to financial instruments measured at cost or amortised cost

11.52 For financial assets measured at amortised cost less impairment, the entity shall disclose the significant terms and conditions that may affect the amount, timing and certainty of future cash flows, including interest rate risk, foreign exchange rate risk and credit risk.

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Appendix A to Section 11
Effective interest rate

This Appendix accompanies, but is not part of, Section 11. It provides guidance for applying the effective interest method in accordance with paragraph 11.7.

11A.1 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.

11A.2 When applying the effective interest method, an entity generally amortises 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 amortisation 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 amortised 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 (ie 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 amortised over the expected life of the instrument.

11A.3 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 recognised 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.

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11A.4 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. The adjustment is recognised as income or expense in profit or loss.

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Appendix B to Section 11
Fair value measurement considerations

This Appendix is an integral part of Section 11.

11B.1 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.

Active market: quoted price

11B.2 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 reporting date in that instrument (ie 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.

11B.3 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

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time of the transaction. If conditions have changed since the time of the transaction (eg a change in the risk-free interest rate following the most recent price quote for a corporate 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 (eg 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.

11B.4 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

11B.5 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.

11B.6 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 business 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

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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.

11B.7 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 (ie without modification or repackaging) or on the basis of 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 is the transaction price (ie 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 (ie without modification or repackaging) or is based on a valuation technique whose variables include only data from observable markets.

11B.8 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 [draft] standard. The application of paragraph 11B.7 may result in no gain or loss being recognised on the initial recognition of a financial asset or financial liability. In such a case, this section requires that a gain or loss shall be recognised 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.

11B.9 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 (ie 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,

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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.

11B.10 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.

11B.11 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

11B.12 The fair value of investments in equity instruments that do not have a quoted market price in an active market and derivatives (options, forward and futures contracts, swaps etc) that are linked to and must be settled by delivery of such an unquoted equity instrument is reliably measurable if

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(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.

11B.13 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 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

11B.14 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 (ie 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 rate, such as LIBOR or a swap rate, as the benchmark rate. (Because a rate such as LIBOR 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.

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(b) *Credit risk*. The effect on fair value of credit risk (ie 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 (ie 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.)

(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.

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Section 12
Inventories

Scope

12.1 **Inventories** are **assets**:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

12.2 This section does not apply to the measurement of inventories held by:

(a) producers of agricultural and forest products, **agricultural produce** after harvest, and minerals and mineral products, to the extent that they are measured at **fair value** less costs to sell through profit or loss; or

(b) commodity brokers and dealers who measure their inventories at fair value less costs to sell through profit or loss.

Measurement of inventories

12.3 An entity shall measure inventories at the lower of cost and selling price less costs to complete and sell.

Cost of inventories

12.4 An entity shall include in the cost of inventories all costs of purchase, costs of conversion and other costs incurred in bringing the inventories to their present location and condition.

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Costs of purchase

12.5 The costs of purchase of inventories comprise the purchase price, import duties and other taxes (other than those subsequently recoverable by the entity from the taxing authorities), and transport, handling and other costs directly attributable to the acquisition of finished goods, materials and services. Trade discounts, rebates and other similar items are deducted in determining the costs of purchase.

12.6 An entity may purchase inventories on deferred settlement terms. When the arrangement effectively contains a financing element, that element, for example a difference between the purchase price for normal credit terms and the amount paid, is recognised as interest expense over the period of the financing.

Costs of conversion

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

Allocation of fixed production overheads

12.8 An entity shall allocate fixed production overheads to the costs of conversion based on the normal capacity of the production facilities. Normal capacity is the production expected to be achieved on average over a number of periods or seasons under normal circumstances, taking into account the loss of capacity resulting from planned maintenance. The actual level of production may be used if it approximates normal capacity. The amount of fixed overhead allocated to each unit of production is not increased as a consequence of low production or idle plant. Unallocated overheads are recognised as an expense in the period in which they are incurred. In periods of abnormally high production,

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the amount of fixed overhead allocated to each unit of production is decreased so that inventories are not measured above cost. Variable production overheads are allocated to each unit of production on the basis of the actual use of the production facilities.

Joint products and by-products

12.9 A production process may result in more than one product being produced simultaneously. This is the case, for example, when joint products are produced or when there is a main product and a by-product. When the costs of conversion of each product are not separately identifiable, an entity shall allocate them between the products on a rational and consistent basis. The allocation may be based, for example, on the relative sales value of each product either at the stage in the production process when the products become separately identifiable, or at the completion of production. Most by-products, by their nature, are immaterial. When this is the case, the entity shall measure them at selling price less costs to complete and sell and deduct this amount from the cost of the main product. As a result, the **carrying amount** of the main product is not materially different from its cost.

Other costs included in inventories

12.10 An entity shall include other costs in the cost of inventories only to the extent that they are incurred in bringing the inventories to their present location and condition. For example, it may be appropriate to include, in the cost of inventories, non-production overheads or the costs of designing products for specific customers. If an entity chooses to capitalise borrowing costs as provided by paragraph 24.2(b), IAS 23 *Borrowing Costs* identifies limited circumstances when borrowing costs are included in the cost of inventories.

12.11 Paragraph 11.33(b) of Section 11 *Financial Assets and Financial Liabilities* provides that, in some circumstances, the change in the fair value of the hedging instrument in a hedge of fixed interest rate risk or commodity price risk of a commodity held adjusts the carrying amount of the commodity.

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Costs excluded from inventories

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

(a) abnormal amounts of wasted materials, labour or other production costs;

(b) storage costs, unless those costs are necessary in the production process before a further production stage;

(c) administrative overheads that do not contribute to bringing inventories to their present location and condition; and

(d) selling costs.

Cost of inventories of a service provider

12.13 To the extent that service providers have inventories, they measure them at the costs of their production. These costs consist primarily of the labour and other costs of personnel directly engaged in providing the service, including supervisory personnel, and attributable overheads. Labour and other costs relating to sales and general administrative personnel are not included but are recognised as expenses in the period in which they are incurred. The cost of inventories of a service provider does not include profit margins or non-attributable overheads that are often factored into prices charged by service providers.

Cost of agricultural produce harvested from biological assets

12.14 Under Section 35 *Specialised Industries*, inventories comprising agricultural produce that an entity has harvested from its biological assets are measured on initial **recognition** at their fair value less estimated costs to sell at the point of harvest. This becomes the cost of the inventories at that date for application of this section.

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Techniques for measuring cost, such as standard costing and retail method

12.15 An entity may use techniques such as the standard cost method or the retail method for measuring the cost of inventories if the results approximate cost. Standard costs take into account normal levels of materials and supplies, labour, efficiency and capacity utilisation. They are regularly reviewed and, if necessary, revised in the light of current conditions. The retail method measures cost by reducing the sales value of the inventory by the appropriate percentage gross margin.

Cost formulas

12.16 An entity shall assign the cost of inventories of items that are not ordinarily interchangeable and goods or services produced and segregated for specific projects by using specific identification of their individual costs.

12.17 An entity shall assign the cost of inventories, other than those dealt with in paragraph 12.16, by using the first-in, first-out (FIFO) or weighted average cost formula. An entity shall use the same cost formula for all inventories having a similar nature and use to the entity. For inventories with a different nature or use, different cost formulas may be justified. The last-in, first-out method (LIFO) is not permitted by this [draft] standard.

Impairment of inventories

12.18 Paragraphs 26.2–26.4 require an entity to assess at each **reporting date** whether any inventories are impaired, ie are not recoverable (for example, because of damage, obsolescence or declining selling prices). If an item (or group of items) of inventory is impaired, those paragraphs require the entity to measure the inventory at its selling price less costs to complete and sell and to recognise an impairment loss. Those paragraphs also require a reversal of a prior impairment in some circumstances.

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Recognition as an expense

12.19 When inventories are sold, the entity shall recognise the carrying amount of those inventories as an expense in the period in which the related revenue is recognised.

12.20 Some inventories may be allocated to other asset accounts, for example, inventory used as a component of self-constructed property, plant or equipment. Inventories allocated to another asset in this way are recognised as an expense during the useful life of that asset.

Disclosures

12.21 An entity shall disclose:

(a) the **accounting policies** adopted in measuring inventories, including the cost formula used;

(b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity;

(c) the amount of inventories recognised as an expense during the period (cost of goods sold);

(d) the amount of any impairment of inventories recognised as an expense in the period in accordance with paragraph 12.18 and paragraphs 26.2–26.4;

(e) the amount of any reversal of any impairment recognised in the period in accordance with paragraph 12.18 and paragraph 26.4, and a description of the circumstances or events that led to such reversal; and

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

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Section 13
Investments in Associates

Associates defined

13.1 An **associate** is an entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.

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

(a) If an investor holds, directly or indirectly (eg through subsidiaries), 20 per cent or more of the voting power of the investee, it is presumed that the investor has significant influence, unless it can be clearly demonstrated that this is not the case.

(b) Conversely, if the investor holds, directly or indirectly (eg through subsidiaries), less than 20 per cent of the voting power of the investee, it is presumed that the investor does not have significant influence, unless such influence can be clearly demonstrated.

(c) A substantial or majority ownership by another investor does not preclude an investor from having significant influence.

Measurement after initial recognition—accounting policy election

13.3 An investor shall account for its investments in all associates using one of the following:

(a) the cost model in paragraph 13.4;

(b) the equity method in paragraph 13.5; or

(c) the **fair value** through profit or loss model in paragraph 13.6.

Cost model

13.4 An investor shall measure its investments in associates at cost less any accumulated impairment losses. The investor shall recognise income from the investment only to the extent that the investor receives distributions from accumulated profits of the associate arising after the

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date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment. The investor shall make disclosures required by this section. The investor shall recognise impairment in accordance with Section 26 *Impairment of Non-financial Assets*.

Equity method

13.5 An investor shall measure its investments in associates by the equity method using the procedures in IAS 28 *Investments in Associates*. The investor shall also make disclosures required by IAS 28.

Fair value through profit or loss model

13.6 An investor shall measure its investments in associates at fair value through profit or loss using the procedures in paragraphs 11.14–11.17 in Section 11 *Financial Assets and Financial Liabilities*. The investor shall make the disclosures required by that section. An investor shall not use the fair value through profit or loss model for any investment in an associate whose fair value cannot be measured reliably.

Disclosures

13.7 An investor in an associate shall disclose:

(a) its **accounting policy** for investments in associates;

(b) the fair value of investments in associates for which there are published price quotations;

(c) summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss, along with the investor's percentage of ownership of the associates; and

(d) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances.

13.8 For investments in associates accounted for by the equity method, an investor shall disclose separately its share of the profit or loss of such associates, the **carrying amount** of those investments, and its share of any **discontinued operations** of such associates.

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Financial statement presentation

13.9 An investor shall classify investments in associates as non-current assets.

Section 14
Investments in Joint Ventures

Joint ventures defined

14.1 **Joint control** is the contractually agreed sharing of **control** over an economic activity, and exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

14.2 A **joint venture** is a contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or **jointly controlled entities**.

Jointly controlled operations

14.3 The operation of some joint ventures involves the use of the assets and other resources of the venturers rather than the establishment of a corporation, partnership or other entity, or a financial structure that is separate from the venturers themselves. Each venturer uses its own property, plant and equipment and carries its own inventories. It also incurs its own expenses and liabilities and raises its own finance, which represent its own obligations. The joint venture activities may be carried out by the venturer's employees alongside the venturer's similar activities. The joint venture agreement usually provides a means by which the revenue from the sale of the joint product and any expenses incurred in common are shared among the venturers.

14.4 In respect of its interests in jointly controlled operations, a venturer shall recognise in its financial statements:

(a) the assets that it controls and the liabilities that it incurs; and

(b) the expenses that it incurs and its share of the income that it earns from the sale of goods or services by the joint venture.

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Jointly controlled assets

14.5 Some joint ventures involve the joint control, and often the joint ownership, by the venturers of one or more assets contributed to, or acquired for the purpose of, the joint venture and dedicated to the purposes of the joint venture.

14.6 In respect of its interest in a jointly controlled asset, a venturer shall recognise in its financial statements:

(a) its share of the jointly controlled assets, classified according to the nature of the assets;

(b) any liabilities that it has incurred;

(c) its share of any liabilities incurred jointly with the other venturers in relation to the joint venture;

(d) any income from the sale or use of its share of the output of the joint venture, together with its share of any expenses incurred by the joint venture; and

(e) any expenses that it has incurred in respect of its interest in the joint venture.

Jointly controlled entities

14.7 A **jointly controlled entity** is a joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

Measurement after initial recognition—accounting policy election

14.8 A venturer shall account for its interest in all jointly controlled entities using one of the following:

(a) the cost model in paragraph 14.9;

(b) the equity method in paragraph 14.10;

(c) proportionate consolidation described in paragraph 14.11; or

(d) the **fair value** through profit or loss model in paragraph 14.12.

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Cost model

14.9 A venturer shall measure its investments in jointly controlled entities at cost less any accumulated impairment losses. The investor shall recognise income from the investment only to the extent that the investor receives distributions from accumulated profits of the investee arising after the date of acquisition. Distributions received in excess of such profits are regarded as a recovery of investment and are recognised as a reduction of the cost of the investment. The venturer shall make disclosures required by this section. The venturer shall recognise impairment in accordance with Section 26 *Impairment of Non-financial Assets*.

Equity method

14.10 A venturer shall measure its investments in jointly controlled entities by the equity method using the procedures in paragraphs 38–40 of IAS 31 *Interests in Joint Ventures*, which in turn refer to IAS 28 *Investments in Associates*. The venturer shall also make the disclosures required by IAS 28.

Proportionate consolidation

14.11 A venturer shall measure its investments in jointly controlled entities by proportionate consolidation using the procedures in paragraphs 30–37 of IAS 31. The venturer shall also make the disclosures required by IAS 31.

Fair value through profit or loss model

14.12 A venturer shall measure its investments in jointly controlled entities at fair value through profit or loss using the procedures in paragraphs 11.14–11.18 in Section 11 *Financial Assets and Liabilities*. The venturer shall make the disclosures required by that section. An investor shall not use the fair value through profit or loss model for any investment in a joint venture whose fair value cannot be measured reliably.

Transactions between a venturer and a joint venture

14.13 When a venturer contributes or sells assets to a joint venture, recognition of any portion of a gain or loss from the transaction shall reflect the substance of the transaction. While the assets are retained by the joint venture, and provided the venturer has transferred the significant risks

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and rewards of ownership, the venturer shall recognise only that portion of the gain or loss that is attributable to the interests of the other venturers. The venturer shall recognise the full amount of any loss when the contribution or sale provides evidence of an impairment loss.

14.14 When a venturer purchases assets from a joint venture, the venturer shall not recognise its share of the profits of the joint venture from the transaction until it resells the assets to an independent party. A venturer shall recognise its share of the losses resulting from these transactions in the same way as profits except that losses shall be recognised immediately when they represent an impairment loss.

If investor does not have joint control

14.15 An investor in a joint venture that does not have joint control shall account for that investment in accordance with Section 11 or, if it has significant influence in the joint venture, in accordance with Section 13 *Investments in Associates*.

Disclosure

14.16 An investor in a joint venture shall disclose the aggregate amount of the following **contingent liabilities**, unless the probability of loss is remote, separately from the amount of other contingent liabilities:

(a) any contingent liabilities that the investor has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities that have been incurred jointly with other venturers;

(b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and

(c) those contingent liabilities that arise because the investor is contingently liable for the liabilities of the other venturers of a joint venture.

14.17 An investor in a joint venture shall also disclose:

(a) the aggregate amount of its commitments relating to joint ventures, including its share in the capital commitments that have been incurred jointly with other venturers, as well as its share of the capital commitments of the joint ventures themselves;

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(b) a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities; and

(c) the method it uses to recognise its interests in jointly controlled entities.

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Section 15
Investment Property

Recognition

15.1 **Investment property** is property (land or a building, or part of a building, or both) held by the owner or by the lessee under a finance lease to earn rentals or for capital appreciation or both, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

15.2 A property interest that is held by a lessee under an operating lease may be classified and accounted for as investment property if, and only if, the property would otherwise meet the definition of an investment property and the lessee uses the fair value model (see paragraph 15.4) for that property interest and for all of its other property classified as investment property.

Measurement at initial recognition

15.3 An entity shall measure investment property at its cost at initial recognition. The cost of a purchased investment property comprises its purchase price and any directly attributable expenditure such as legal and brokerage fees, property transfer taxes and other transaction costs. An entity shall follow paragraphs 16.6–16.10 to determine the cost of a self-constructed investment property.

Measurement after recognition—accounting policy election

15.4 An entity shall measure all of its investment property after initial recognition using either:

(a) the **fair value** model in paragraph 15.5; or

(b) the cost model in paragraph 15.6.

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Fair value model

15.5 An entity that elects to use the fair value model shall apply IAS 40 *Investment Property* (see especially paragraphs 33–55) and shall make the disclosures required by paragraphs 75–78 of that standard.

Cost model

15.6 An entity that elects to use the cost model shall account for all of its investment property as property, plant and equipment in accordance with the requirements for the cost model in Section 16 *Property, Plant and Equipment*. The entity shall make the disclosures required by that section.

Transfers

15.7 An entity shall transfer a property to, or from, investment property only when the property first meets, or ceases to meet, the definition of investment property.

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Section 16
Property, Plant and Equipment

Recognition

16.1 **Property, plant and equipment** are tangible assets 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 period.

16.2 Spare parts and servicing equipment are usually carried as inventory and recognised in profit or loss as consumed. However, major spare parts and stand-by equipment are property, plant and equipment when an entity expects to use them during more than one period. Similarly, if the spare parts and servicing equipment can be used only in connection with an item of property, plant and equipment, they are considered property, plant and equipment.

16.3 Parts of some items of property, plant and equipment may require replacement at regular intervals. An entity shall add to the **carrying amount** of an item of property, plant and equipment the cost of replacing part of such an item when that cost is incurred if the replacement part is expected to provide incremental future benefits to the entity. The carrying amount of those parts that are replaced is **derecognised** in accordance with paragraphs 16.24–16.27.

16.4 A condition of continuing to operate an item of property, plant and equipment (for example, a bus) may be performing regular major inspections for faults regardless of whether parts of the item are replaced. When each major inspection is performed, its cost is recognised in the carrying amount of the item of property, plant and equipment as a replacement if the recognition criteria are satisfied. Any remaining carrying amount of the cost of the previous inspection (as distinct from physical parts) is derecognised. This is done regardless of whether the cost of the previous inspection was identified in the transaction in which the item was acquired or constructed. If necessary, the estimated cost of a future similar inspection may be used as an indication of what the cost of the existing inspection component was when the item was acquired or constructed.

16.5 Land and buildings are separable assets, and an entity shall account for them separately, even when they are acquired together.

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Measurement at recognition

16.6 An entity shall measure an item of property, plant and equipment at initial recognition at its cost.

Elements of cost

16.7 The cost of an item of property, plant and equipment comprises:

(a) its purchase price, including legal and brokerage fees, import duties and non-refundable purchase taxes, after deducting trade discounts and rebates.

(b) any costs directly attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. These can include the costs of site preparation, initial delivery and handling, installation and assembly, and testing of functionality.

(c) the initial estimate of the costs of dismantling and removing the item and restoring the site on which it is located, the obligation for which an entity incurs either when the item is acquired or as a consequence of having used the item during a particular period for purposes other than to produce inventories during that period.

16.8 The following costs are not costs of an item of property, plant and equipment, and an entity shall recognise them as an expense when they are incurred:

(a) costs of opening a new facility;

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

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

(d) administration and other general overhead costs.

16.9 The income and related expenses of incidental operations during construction or development of an item of property, plant and equipment are recognised in profit or loss if those operations are not necessary to bring the item to its intended location and operating condition.

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Measurement of cost

16.10 The cost of an item of property, plant and equipment is the cash price equivalent at the recognition date. If payment is deferred beyond normal credit terms, the cost is the **present value** of all future payments. If property, plant or equipment is acquired in exchange for a non-monetary asset or assets, or a combination of monetary and non-monetary assets, the cost of the acquired asset is measured at **fair value** unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. In this case, the asset's cost is measured at the carrying amount of the asset given up.

Measurement after initial recognition—accounting policy election

16.11 An entity shall account for all items in the same class of property, plant and equipment after initial recognition using either:

(a) the cost model in paragraph 16.12; or

(b) the revaluation model in paragraph 16.13.

Cost model

16.12 An entity shall measure an item of property, plant and equipment at cost less any accumulated **depreciation** and any accumulated **impairment** losses.

Revaluation model

16.13 An entity that elects to use the revaluation model for a class of items of property, plant and equipment shall apply paragraphs 31–42 of IAS 16 *Property, Plant and Equipment* and shall make the disclosures required by paragraph 77 of IAS 16.

Depreciation

16.14 An entity shall allocate the amount initially recognised in respect of an item of property, plant and equipment to its significant parts and depreciate separately each such part. However, if a significant part of an item of property, plant and equipment has a **useful life** and a depreciation method that are the same as the useful life and the

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depreciation method of another significant part of that same item, those parts may be grouped in determining the depreciation charge. With some exceptions, such as quarries and sites used for landfill, land has an unlimited useful life and therefore is not depreciated.

16.15 The depreciation charge for each period shall be recognised in profit or loss unless it is included in the carrying amount of another asset. For example, the depreciation of manufacturing property, plant and equipment is included in the costs of inventories (see Section 12 *Inventories*).

Depreciable amount and depreciation period

16.16 An entity shall allocate the **depreciable amount** of an asset on a systematic basis over its useful life.

16.17 An entity shall review the **residual value** and the **useful life** of an asset at least at each annual **reporting date** and, if expectations differ from previous estimates, amend the residual value or useful life. The entity shall account for the change in residual value or useful life as a change in an **accounting estimate** in accordance with paragraphs 10.13–10.17.

16.18 Depreciation of an asset begins when it is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Depreciation of an asset ceases 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 paragraphs 36.5–36.7 and the date that the asset is derecognised. Depreciation does not cease when the asset becomes idle or is retired from active use unless the asset is fully depreciated. However, under usage methods of depreciation the depreciation charge can be zero while there is no production.

16.19 An entity shall consider all the following factors in determining the useful life of an asset:

(a) the expected usage of the asset. Usage is assessed by reference to the asset's expected capacity or physical output.

(b) expected physical wear and tear, which depends on operational factors such as the number of shifts for which the asset is to be used and the repair and maintenance programme, and the care and maintenance of the asset while idle.

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(c) technical or commercial obsolescence arising from changes or improvements in production, or from a change in the market demand for the product or service output of the asset.

(d) legal or similar limits on the use of the asset, such as the expiry dates of related leases.

Depreciation method

16.20 An entity shall select a depreciation method that reflects the pattern in which it expects to consume the asset's future economic benefits. The possible depreciation methods include the straight-line method, the diminishing balance method and the units of production method.

16.21 An entity shall review the depreciation method at least at each annual reporting date. If there has been a significant change in the pattern in which the entity expects to consume the asset's future economic benefits, the entity shall change the method to reflect the new pattern. The entity shall account for the change as a change in an accounting estimate in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Impairment

16.22 At the end of each **reporting period**, an entity shall apply Section 26 *Impairment of Non-financial Assets* to determine whether an item or group of items of property, plant and equipment is impaired and, if so, how to recognise and measure the impairment loss. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the fair value less costs to sell of an asset, and when it recognises or reverses an impairment loss.

Compensation for impairment

16.23 An entity shall include in profit or loss compensation from third parties for items of property, plant and equipment that were impaired, lost or given up only when the compensation becomes receivable.

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Derecognition

16.24 An entity shall derecognise an item of property, plant and equipment:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

16.25 An entity shall recognise the gain or loss on the derecognition of an item of property, plant and equipment in profit or loss when the item is derecognised (unless Section 19 *Leases* requires otherwise on a sale and leaseback). The entity shall not classify such gains as revenue.

16.26 In determining the date of disposal of an item, an entity shall apply the criteria in Section 22 *Revenue* for recognising revenue from the sale of goods. Section 19 applies to disposal by a sale and leaseback.

16.27 An entity shall determine the gain or loss arising from the derecognition of an item of property, plant and equipment as the difference between the net disposal proceeds, if any, and the carrying amount of the item.

Property, plant and equipment held for sale

16.28 Paragraphs 36.5–36.7 specify requirements for property, plant and equipment and other non-current assets that are held for sale.

Disclosure

16.29 An entity shall disclose, for each class of property, plant and equipment:

(a) the measurement bases used for determining the gross carrying amount;

(b) the depreciation methods used;

(c) the useful lives or the depreciation rates used;

(d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and

(e) a reconciliation of the carrying amount at the beginning and end of the period showing:

(i) additions;

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(ii) disposals, including assets classified as held for sale or included in a disposal group classified as held for sale;

(iii) acquisitions through **business combinations**;

(iv) impairment losses recognised or reversed in profit or loss in accordance with Section 26;

(v) depreciation;

(vi) the net exchange differences arising on the translation of the **financial statements** from the **functional currency** into a different **presentation currency**, including the translation of a foreign operation into the presentation currency of the reporting entity (see Section 30 *Foreign Currency Translation*); and

(vii) other changes.

16.30 The entity shall also disclose:

(a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities;

(b) the amount of contractual commitments for the acquisition of property, plant and equipment; and

(c) if it is not disclosed separately on the face of the income statement, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is recognised in profit or loss.

16.31 An entity shall present property, plant and equipment that is held for sale separately from other assets on the face of the balance sheet. The entity shall present any liabilities related to property, plant and equipment that is held for sale separately from other liabilities on the face of the balance sheet.

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Section 17
Intangible Assets other than Goodwill

17.1 An **intangible asset** is an identifiable non-monetary asset without physical substance. Such an asset is identifiable when:

(a) it is separable, ie capable of being separated or divided from the entity and sold, transferred, licensed, rented or exchanged, either individually or together with a related contract, asset or liability; or

(b) it arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

Recognition

General principle for recognising intangible assets

17.2 An entity shall apply the recognition criteria in paragraph 2.24 in determining whether to recognise an intangible asset. Therefore, the entity shall recognise an intangible asset as an asset only if:

(a) it is **probable** that the expected future economic benefits that are attributable to the asset will flow to the entity; and

(b) the cost or value of the asset can be measured reliably.

17.3 An entity shall assess the probability of expected future economic benefits using reasonable and supportable assumptions that represent management's best estimate of the economic conditions that will exist over the useful life of the asset.

17.4 An entity uses judgement to assess the degree of certainty attached to the flow of future economic benefits 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.

17.5 The probability recognition criterion in paragraph 17.2(a) is always considered satisfied for intangible assets that are separately acquired.

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Acquisition as part of a business combination

17.6 An intangible asset acquired in **business combinations** is normally recognised as an asset because its **fair value** can be measured with sufficient reliability. However, an intangible asset acquired in a business combination is not recognised when it arises from legal or other contractual rights and its fair value cannot be measured reliably because the asset either

(a) is not separable from **goodwill**; or

(b) is separable from goodwill but there is no history or evidence of exchange transactions for the same or similar assets, and otherwise estimating fair value would be dependent on immeasurable variables.

Initial measurement

17.7 An entity shall measure an intangible asset initially at cost.

Separate acquisition

17.8 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.

Acquisition as part of a business combination

17.9 If an intangible asset is acquired in a business combination, the cost of that intangible asset is its **fair value** at the acquisition date.

Acquisition by way of a government grant

17.10 Section 23 *Government Grants* prescribes the accounting for intangible assets acquired by way of a government grant.

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Exchanges of assets

17.11 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. An entity shall measure the cost of such an intangible asset at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable.

17.12 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.

17.13 If the entity is not able to determine reliably the fair value of the acquired asset, its cost is measured at the **carrying amount** of the asset given up.

Internally generated intangible assets other than goodwill—accounting policy election

17.14 The creation of internally generated intangible assets other than goodwill involves a **research** phase and a **development** phase. An entity shall choose either the expense model in paragraph 17.15 or the capitalisation model in paragraph 17.16 as its **accounting policy** for costs incurred in research and development activities.

Expense model

17.15 An entity shall recognise all costs incurred in research and development activities as an expense when incurred.

Capitalisation model

17.16 Under the capitalisation model, all costs incurred in research activities are recognised as an expense when incurred. Costs incurred in development activities are also recognised as expense except for those development costs incurred after specified criteria are met, which are recognised as the cost of an intangible asset. An entity that chooses the capitalisation model as its accounting policy shall follow the requirements of paragraphs 51–67 of IAS 38 *Intangible Assets*.

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Recognition as an expense

17.17 An entity shall recognise expenditure on an intangible item as an expense when it is incurred unless it forms part of the cost of an intangible asset that meets the recognition criteria in paragraphs 17.2–17.16.

17.18 An entity shall recognise expenditure on the following items as an expense and shall not recognise such expenditure as intangible assets:

(a) internally generated brands, mastheads, publishing titles, customer lists and items similar in substance;

(b) expenditure on start-up activities (ie start-up costs), unless this expenditure is included in the cost of an item of property, plant and equipment in accordance with Section 16 *Property, Plant and Equipment*. 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 business (ie pre-opening costs) or expenditure for starting new operations or launching new products or processes (ie pre-operating costs);

(c) expenditure on training activities;

(d) expenditure on advertising and promotional activities; and

(e) expenditure on relocating or reorganising part or all of an entity.

17.19 Paragraph 17.18 does not preclude recognising a prepayment as an asset when payment for the delivery of goods or services has been made in advance of the delivery of goods or the rendering of services.

Past expenses not to be recognised as an asset

17.20 Expenditure on an intangible item that was initially recognised as an expense shall not be recognised at a later date as part of the cost of an intangible asset.

Measurement after recognition—accounting policy election

17.21 An entity shall account for each class of intangible assets after initial recognition using either:

(a) the cost model in paragraph 17.22; or

(b) the revaluation model in paragraph 17.23.

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Cost model

17.22 An entity shall measure an intangible asset at cost less any accumulated **amortisation** and any accumulated **impairment** losses. The requirements for amortisation are set out in this section. The requirements for recognition of impairment are set out in Section 26 *Impairment of Non-financial Assets*.

Revaluation model

17.23 An entity shall apply paragraphs 75–87 of IAS 38 and shall make the disclosures required by paragraphs 124 and 125 of IAS 38.

Useful life

17.24 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 entity shall regard an intangible asset 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 the entity.

17.25 The useful life of an intangible asset that arises from contractual or other legal rights shall not exceed the period of the contractual or other legal rights, but may be shorter depending on the period over which the entity expects to use the asset. If the contractual 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.

Intangible assets with finite useful lives

Amortisation period and amortisation method

17.26 An entity shall allocate the depreciable amount of an intangible asset with a finite useful life on a systematic basis over its useful life. Amortisation shall begin when the asset is available for use, ie when it is in the location and condition necessary for it to be capable of operating in the manner intended by management. Amortisation 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

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paragraphs 36.5–36.7 and the date that the asset is derecognised. The entity shall choose an amortisation method that reflects the pattern in which it expects to consume the asset's future economic benefits. If the entity cannot determine that pattern reliably, it shall use the straight-line method. The entity shall recognise the amortisation charge for each period in profit or loss unless this [draft] standard permits or requires it to be included in the carrying amount of another asset.

Residual value

17.27 An entity shall assume that the residual value of an intangible asset with a finite useful life is zero unless:

(a) there is a commitment by a third party to purchase 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.

Review of amortisation period and amortisation method

17.28 An entity shall review the amortisation period and the amortisation method for an intangible asset with a finite useful life at least at each financial year-end. If the expected useful life of the asset is different from previous estimates, the entity shall change the amortisation period accordingly. If there has been a change in the expected pattern of consumption of the future economic benefits embodied in the asset, the entity shall change the amortisation method to reflect the changed pattern. The entity shall account for such changes as changes in **accounting estimates** in accordance with Section 10 *Accounting Policies, Estimates and Errors*.

Intangible assets with indefinite useful lives

No amortisation

17.29 An entity shall not amortise an intangible asset with an indefinite useful life.

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Recoverability of the carrying amount—impairment losses

17.30 To determine whether an intangible asset is impaired, an entity shall apply Section 26 *Impairment of Non-financial Assets*. That section explains when and how an entity reviews the carrying amount of its assets, how it determines the fair value less costs to sell of an asset, and when it recognises or reverses an impairment loss.

Retirements and disposals

17.31 An entity shall derecognise an intangible asset, and shall recognise a gain or loss in profit or loss:

(a) on disposal; or

(b) when no future economic benefits are expected from its use or disposal.

Disclosures

17.32 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 amortisation rates used.

(b) the amortisation methods used for intangible assets with finite useful lives.

(c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period.

(d) the line item(s) of the income statement in which any amortisation of intangible assets is included.

(e) a reconciliation of the carrying amount at the beginning and end of the period showing separately additions, disposals, amortisations, impairment losses, and other changes.

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17.33 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 amortisation period of any individual intangible asset that is **material** to the entity's **financial statements**.

(c) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 17.10):

(i) the fair value initially recognised for these assets;

(ii) their carrying amount; and

(iii) whether they are measured after recognition using 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.

17.34 An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.

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Section 18
Business Combinations and Goodwill

18.1 A **business combination** is the bringing together of separate entities or businesses into one reporting entity. The result of nearly all business combinations is that one entity, the acquirer, obtains control of one or more other businesses, the acquiree. The acquisition date is the date on which the acquirer effectively obtains control of the acquiree.

18.2 A business combination may be structured in a variety of ways for legal, taxation or other reasons. It may involve the purchase by an entity of the equity of another entity, the purchase of all the net assets of another entity, the assumption of the liabilities of another entity, or the purchase of some of the net assets of another entity that together form one or more **businesses**.

18.3 A business combination may be effected by the issue of equity instruments, the transfer of cash, **cash equivalents** or other assets, or a combination thereof. The transaction may be between the shareholders of the combining entities or between one entity and the shareholders of another entity. It may involve the establishment of a new entity to control the combining entities or net assets transferred, or the restructuring of one or more of the combining entities.

18.4 This section specifies the accounting for all business combinations except combinations of entities or businesses under common **control**. Common control means that all of the combining entities or businesses are ultimately controlled by the same party both before and after the business combination, and that control is not transitory.

Accounting

18.5 All business combinations shall be accounted for by applying the purchase method.

18.6 Applying the purchase method involves the following steps:

(a) identifying an acquirer;

(b) measuring the cost of the business combination; and

(c) allocating, at the acquisition date, the cost of the business combination to the assets acquired and liabilities and contingent liabilities assumed.

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Identifying the acquirer

18.7 An acquirer shall be identified for all business combinations. The acquirer is the combining entity that obtains control of the other combining entities or businesses.

18.8 Control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities. Control of one entity by another is described in Section 9 *Consolidated and Separate Financial Statements*.

18.9 Although it may sometimes be difficult to identify an acquirer, there are usually indications that one exists. For example:

(a) if the **fair value** of one of the combining entities is significantly greater than that of the other combining entity, the entity with the greater fair value is likely to be the acquirer;

(b) if the business combination is effected through an exchange of voting ordinary equity instruments for cash or other assets, the entity giving up cash or other assets is likely to be the acquirer; and

(c) if the business combination results in the management of one of the combining entities being able to dominate the selection of the management team of the resulting combined entity, the entity whose management is able so to dominate is likely to be the acquirer.

Cost of a business combination

18.10 The acquirer shall measure the cost of a business combination as the aggregate of:

(a) the fair values, at the date of exchange, of assets given, liabilities incurred or assumed, and equity instruments issued by the acquirer, in exchange for control of the acquiree; plus

(b) any costs directly attributable to the business combination.

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Adjustments to the cost of a business combination contingent on future events

18.11 When a business combination agreement provides for an adjustment to the cost of the combination contingent on future events, the acquirer shall include the amount of that adjustment in the cost of the combination at the acquisition date if the adjustment is **probable** and can be measured reliably.

18.12 However, if the potential adjustment is not recognised at the acquisition date but subsequently becomes probable and can be measured reliably, the additional consideration shall be treated as an adjustment to the cost of the combination.

Allocating the cost of a business combination to the assets acquired and liabilities and contingent liabilities assumed

18.13 The acquirer shall, at the acquisition date, allocate the cost of a business combination by recognising the acquiree's identifiable assets and liabilities and those contingent liabilities that satisfy the recognition criteria in paragraph 18.18 at their fair values at that date, except for non-current assets (or disposal groups) that are classified as held for sale, which shall be recognised at fair value less costs to sell. Any difference between the cost of the business combination and the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities so recognised shall be accounted for in accordance with paragraphs 18.20–18.22.

18.14 The acquirer shall recognise separately the acquiree's identifiable assets, liabilities and contingent liabilities at the acquisition date only if they satisfy the following criteria at that date:

(a) in the case of an asset other than an intangible asset, it is probable that any associated future economic benefits will flow to the acquirer, and its fair value can be measured reliably.

(b) in the case of a liability other than a contingent liability, it is probable that an outflow of resources will be required to settle the obligation, and its fair value can be measured reliably.

(c) in the case of an intangible asset or a contingent liability, its fair value can be measured reliably.

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18.15 The acquirer's income statement shall incorporate the acquiree's profits and losses after the acquisition date by including the acquiree's income and expenses based on the cost of the business combination to the acquirer. For example, depreciation expense included after the acquisition date in the acquirer's income statement that relates to the acquiree's depreciable assets shall be based on the fair values of those depreciable assets at the acquisition date, ie their cost to the acquirer.

18.16 Application of the purchase method starts from the acquisition date, which is the date on which the acquirer obtains control of the acquiree. Because control is the power to govern the financial and operating policies of an entity or business so as to obtain benefits from its activities, it is not necessary for a transaction to be closed or finalised at law before the acquirer obtains control. All pertinent facts and circumstances surrounding a business combination shall be considered in assessing when the acquirer has obtained control.

18.17 In accordance with paragraph 18.13, the acquirer recognises separately only the identifiable assets, liabilities and contingent liabilities of the acquiree that existed at the acquisition date and satisfy the recognition criteria in paragraph 18.14. Therefore:

(a) the acquirer shall recognise liabilities for terminating or reducing the activities of the acquiree as part of allocating the cost of the combination only when the acquiree has, at the acquisition date, an existing liability for restructuring recognised in accordance with Section 20 *Provisions and Contingencies*; and

(b) the acquirer, when allocating the cost of the combination, shall not recognise liabilities for future losses or other costs expected to be incurred as a result of the business combination.

Contingent liabilities

18.18 Paragraph 18.14 specifies that the acquirer recognises separately a contingent liability of the acquiree only if its fair value can be measured reliably. If its fair value cannot be measured reliably:

(a) there is a resulting effect on the amount recognised as goodwill or accounted for in accordance with paragraph 18.22; and

(b) the acquirer shall disclose the information about that contingent liability as required by Section 20.

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18.19 After their initial recognition, the acquirer shall measure contingent liabilities that are recognised separately in accordance with paragraph 18.13 at the higher of:

(a) the amount that would be recognised in accordance with Section 20, and

(b) the amount initially recognised less, when appropriate, cumulative **amortisation** recognised in accordance with Section 22 *Revenue*.

Goodwill

18.20 The acquirer shall, at the acquisition date:

(a) recognise **goodwill** acquired in a business combination as an asset; and

(b) initially measure that goodwill at its cost, being the excess of the cost of the business combination over the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 18.13.

18.21 After initial recognition, the acquirer shall measure goodwill acquired in a business combination at cost less any accumulated impairment losses. Section 26 *Impairment of Non-financial Assets* specifies principles for recognising and measuring the impairment of goodwill.

Excess over cost of acquirer's interest in the net fair value of acquiree's identifiable assets, liabilities and contingent liabilities

18.22 If the acquirer's interest in the net fair value of the identifiable assets, liabilities and contingent liabilities recognised in accordance with paragraph 18.13 exceeds the cost of the business combination (sometimes referred to as 'negative goodwill'), the acquirer shall:

(a) reassess the identification and measurement of the acquiree's identifiable assets, liabilities and contingent liabilities and the measurement of the cost of the combination; and

(b) recognise immediately in profit or loss any excess remaining after that reassessment.

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Disclosure

For business combination(s) effected during the reporting period

18.23 For each business combination that was effected during the period (or group of individually immaterial business combinations), the acquirer shall disclose the following:

(a) the names and descriptions of the combining entities or businesses.

(b) the acquisition date.

(c) the percentage of voting equity instruments acquired.

(d) the cost of the combination and a description of the components of that cost, including any costs directly attributable to the combination. When equity instruments are issued or issuable as part of the cost, the following shall also be disclosed:

(i) the number of equity instruments issued or issuable; and

(ii) the fair value of those instruments and the basis for determining that fair value.

(e) details of any operations the entity has decided to dispose of as a result of the combination.

(f) the amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities and contingent liabilities, including goodwill.

(g) the amount of any excess recognised in profit or loss in accordance with paragraph 18.22, and the line item in the income statement in which the excess is recognised.

(h) a description of the factors that contributed to a cost that results in the recognition of goodwill—a description of each intangible asset that was not recognised separately from goodwill and an explanation of why the intangible asset's fair value could not be measured reliably—or a description of the nature of any excess recognised in profit or loss in accordance with paragraph 18.22.

(i) the amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless disclosure would be **impracticable**. If such disclosure would be

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impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

For business combination(s) effected after the end of the reporting period but before the financial statements are authorised for issue

18.24 For each business combination effected after the end of the **reporting period** but before the **financial statements** are authorised for issue, the acquirer shall make the disclosures required by paragraph 18.23 unless such disclosure would be impracticable. If disclosure of any of that information would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

For all business combinations

18.25 An acquirer shall disclose a reconciliation of the **carrying amount** of goodwill at the beginning and end of the reporting period, showing separately changes arising from new business combinations, **impairment** losses, disposals of previously acquired businesses, and other changes. An acquirer shall also disclose the gross amount and accumulated impairment losses at the end of the period.

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Section 19
Leases

19.1 This section shall be applied in accounting for all **leases** other than:

(a) leases to explore for or use minerals, oil, natural gas and similar non-regenerative resources (see Section 35 *Specialised Industries*);

(b) licensing agreements for such items as motion picture films, video recordings, plays, manuscripts, patents and copyrights (see Section 17 *Intangible Assets other than Goodwill*);

(c) property held by lessees that is accounted for as **investment property** (see Section 15 *Investment Property*);

(d) investment property provided by lessors under operating leases (see Section 15); and

(e) leases that could result in a loss to the lessor or the lessee as a result of contractual terms that are unrelated to changes in the price of the leased asset, changes in foreign exchange rates, or a default by one of the counterparties (see paragraph 11.3(e) in Section 11 *Financial Assets and Financial Liabilities*.

19.2 This section applies to agreements that transfer the right to use assets even though substantial services by the lessor may be called for in connection with the operation or maintenance of such assets. This section does not apply to agreements that are contracts for services that do not transfer the right to use assets from one contracting party to the other.

Classification of leases

19.3 A lease is classified as a **finance lease** if it transfers substantially all the risks and rewards incidental to ownership. A lease is classified as an **operating lease** if it does not transfer substantially all the risks and rewards incidental to ownership.

19.4 Whether a lease is a finance lease or an operating lease depends on the substance of the transaction rather than the form of the contract. Examples of situations that individually or in combination would normally lead to a lease being classified as a finance lease are:

(a) the lease transfers ownership of the asset to the lessee by the end of the lease term.

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(b) the lessee has the option to purchase the asset at a price that is expected to be sufficiently lower than the **fair value** at the date the option becomes exercisable for it to be reasonably certain, at the inception of the lease, that the option will be exercised.

(c) the lease term is for the major part of the economic life of the asset even if title is not transferred.

(d) at the inception of the lease the **present value** of the minimum lease payments amounts to at least substantially all of the fair value of the leased asset.

(e) the leased assets are of such a specialised nature that only the lessee can use them without major modifications.

19.5 Indicators of situations that individually or in combination could also lead to a lease being classified as a finance lease are:

(a) if the lessee can cancel the lease, the lessor's losses associated with the cancellation are borne by the lessee;

(b) gains or losses from the fluctuation in the **residual value** of the leased asset accrue to the lessee (for example, in the form of a rent rebate equalling most of the sales proceeds at the end of the lease); and

(c) the lessee has the ability to continue the lease for a secondary period at a rent that is substantially lower than market rent.

19.6 The examples and indicators in paragraphs 19.4 and 19.5 are not always conclusive. If it is clear from other features that the lease does not transfer substantially all risks and rewards incidental to ownership, the lease is classified as an operating lease. For example, this may be the case if ownership of the asset transfers to the lessee at the end of the lease for a variable payment equal to the asset's then fair value, or if there are contingent rents, as a result of which the lessee does not have substantially all risks and rewards incidental to ownership.

19.7 Lease classification is made at the inception of the lease and is not changed during the term of the lease unless the lessee and the lessor agree to change the provisions of the lease (other than simply by renewing the lease), in which case the lease classification shall be re-evaluated.

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Financial statements of lessees—finance leases

Initial recognition

19.8 At the commencement of the lease term, lessees shall recognise the rights and obligations under finance leases as assets and liabilities in their balance sheet at amounts equal to the fair value of the leased property determined at the inception of the lease. Any initial direct costs of the lessee (incremental costs that are directly attributable to negotiating and arranging a lease) are added to the amount recognised as an asset.

Subsequent measurement

19.9 A lessee shall apportion minimum lease payments between the finance charge and the reduction of the outstanding liability. The lessee shall allocate the finance charge to each period during the lease term so as to produce a constant periodic rate of interest on the remaining balance of the liability. A lessee shall charge contingent rents as expenses in the periods in which they are incurred.

19.10 In allocating the finance charge to periods during the lease term, a lessee may use an approximation to simplify the calculation.

19.11 A lessee shall depreciate an asset leased under a finance lease in accordance with Section 16 *Property, Plant and Equipment*. 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.

Disclosures

19.12 Lessees shall make the following disclosures for finance leases:

(a) for each **class of asset**, the net carrying amount at the end of the **reporting period**.

(b) the total of future minimum lease payments at the end of the reporting period, for each future year.

(c) contingent rents recognised as an expense.

(d) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the end of the reporting period.

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(e) a general description of the lessee's leasing arrangements including, but not limited to, the following:

   (i) the basis on which contingent rent payable is determined;

   (ii) the existence and terms of renewal or purchase options and escalation clauses; and

   (iii) restrictions imposed by lease arrangements, such as those concerning dividends additional debt and further leasing.

Financial statements of lessees—operating leases

Recognition and measurement

19.13 A lessee shall recognise lease payments under operating leases (excluding costs for services such as insurance and maintenance) as an expense on a straight-line basis unless another systematic basis is representative of the time pattern of the user's benefit, even if the payments are not on that basis.

Disclosures

19.14 Lessees shall make the following disclosures for operating leases:

(a) the total of future minimum lease payments under non-cancellable operating leases for each future year.

(b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the end of the reporting period.

(c) lease and sublease payments recognised as an expense, with separate amounts for minimum lease payments, contingent rents, and sublease payments.

(d) a general description of the lessee's significant leasing arrangements including, but not limited to, the following:

   (i) the basis on which contingent rent payable is determined;

   (ii) the existence and terms of renewal or purchase options and escalation clauses; and

   (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt and further leasing.

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Financial statements of lessors: finance leases

19.15 A lessor in a finance lease shall apply paragraphs 36–46 of IAS 17 *Leases* and shall make the disclosures required by paragraph 47 of IAS 17.

Financial statements of lessors: operating leases

Recognition and measurement

19.16 A lessor shall present assets subject to operating leases in its balance sheets according to the nature of the asset.

19.17 A lessor shall recognise lease income from operating leases in profit or loss on a straight-line basis over the lease term, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

19.18 A lessor shall recognise as an expense costs, including depreciation, incurred in earning the lease income. A lessor shall recognise lease income (excluding receipts for services provided such as insurance and maintenance) on a straight-line basis over the lease term even if the receipts are not on such a basis, unless another systematic basis is more representative of the time pattern in which use benefit derived from the leased asset is diminished.

19.19 A lessor shall add to the carrying amount of the leased asset any initial direct costs it incurs in negotiating and arranging an operating lease and shall recognise such costs as an expense over the lease term on the same basis as the lease income.

19.20 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 Section 16 and IAS 38 *Intangible Assets*.

19.21 To determine whether a leased asset has become impaired, a lessor shall apply Section 26 *Impairment of Non-financial Assets*.

19.22 A manufacturer or dealer lessor does not recognise any selling profit on entering into an operating lease because it is not the equivalent of a sale.

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Disclosure

19.23 Lessors shall disclose the following for operating leases:

(a) the future minimum lease payments under non-cancellable operating leases in the aggregate and for each future year;

(b) total contingent rents recognised as income; and

(c) a general description of the lessor's leasing arrangements.

Sale and leaseback transactions

19.24 A sale and leaseback transaction involves the sale of an asset and the leasing back of the same asset. The lease payment and the sale price are usually interdependent because they are negotiated as a package. The accounting treatment of a sale and leaseback transaction depends on the type of lease.

Sale and leaseback transaction results in a finance lease

19.25 If a sale and leaseback transaction results in a finance lease, the seller-lessee shall not recognise immediately, as income, any excess of sales proceeds over the carrying amount. Instead, the seller-lessee shall defer such excess and amortise it over the lease term.

Sale and leaseback transaction results in an operating lease

19.26 If a sale and leaseback transaction results in an operating lease, and it is clear that the transaction is established at **fair value**, the seller-lessee shall recognise any profit or loss immediately. If the sale price is below fair value, the seller-lessee shall recognise any profit or loss immediately unless the loss is compensated for by future lease payments at below market price. In that case the seller-lessee shall defer and amortise such loss in proportion to the lease payments over the period for which the asset is expected to be used. If the sale price is above fair value, the seller-lessee shall defer the excess over fair value and amortise it over the period for which the asset is expected to be used.

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Disclosure

19.27 Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of leasing arrangements includes description of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

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Section 20
Provisions and Contingencies

20.1 A **provision** is a liability of uncertain timing or amount.

20.2 The requirements in this section do not apply to provisions that are covered by other sections of this [draft] standard. These include:

(a) leases (Section 19 *Leases*);

(b) construction contracts (Section 22 *Revenue*);

(c) employee benefit obligations (Section 27 *Employee Benefits*); and

(d) income taxes (Section 28 *Income Taxes*).

20.3 The word 'provision' is sometimes used in the context of such items as depreciation, impairment of assets, and uncollectible receivables. Those are adjustments of the **carrying amount**s of assets, rather than recognition of liabilities, and are therefore not covered by this section.

Initial recognition

20.4 An entity shall recognise a provision only when:

(a) the entity has a present obligation as a result of a past event, and

(b) it is **probable** (ie more likely than not) that the entity will be required to transfer economic benefits in settlement; and

(c) the amount of the obligation can be estimated reliably.

20.5 In rare cases, it is not clear whether there is a present obligation. In those cases, a past event is deemed to give rise to a present obligation if, taking account of all available evidence, it is probable that a present obligation exists at the **reporting date**.

20.6 The entity shall recognise the provision as a liability in the balance sheet and shall recognise the amount of the provision as an expense in profit or loss unless (a) it is part of the cost of producing inventories (see paragraph 12.4) or (b) it is included in the cost of property, plant and equipment in accordance with paragraph 16.7.

20.7 The condition in paragraph 20.4(a) (present obligation arising from a past event) means that the entity has no realistic alternative to settling the obligation. This can happen when the obligation can be enforced by law or when the entity has a **constructive obligation** because the past event

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has created valid expectations in other parties that the entity will discharge the obligation. Obligations that will arise from the entity's future actions (ie the future conduct of its business) do not satisfy the condition in paragraph 20.4(a), no matter how likely they are to occur and even if they are contractual. To illustrate, because of commercial pressures or legal requirements, an entity may intend or need to carry out expenditure to operate in a particular way in the future (for example, by fitting smoke filters in a certain type of factory). Because the entity can avoid the future expenditure by its future actions, for example by changing its method of operation, it has no present obligation for that future expenditure and no provision is recognised.

Initial measurement

20.8 An entity shall measure a provision at the best estimate of the amount required to settle the obligation at the reporting date.

(a) When the provision involves a large population of items, the estimate of the amount reflects the weighting of all possible outcomes by their associated probabilities.

(b) When the provision arises from a single obligation, the individual most likely outcome may be the best estimate of the amount required to settle the obligation. However, even in such a case, the entity considers other possible outcomes. Where other possible outcomes are either mostly higher or mostly lower than the most likely outcome, the best estimate will be a higher or lower amount.

When the effect of the time value of money is **material**, the amount of a provision shall be the **present value** of the amount expected to be required to settle the obligation. The discount rate (or rates) shall be a pre-tax rate (or rates) that reflect(s) current market assessments of the time value of money. The risks specific to the liability should be reflected either in the discount rate or in the estimation of the amounts required to settle the obligation, but not both.

20.9 When some or all of the amount required to settle a provision may be reimbursed by another party (eg through an insurance claim), the entity shall recognise the reimbursement as a separate asset only when it is virtually certain that the entity will receive the reimbursement on settlement of the obligation. The reimbursement receivable shall be presented on the balance sheet as an asset and shall not be offset against

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the provision. In the income statement, the entity may offset any reimbursement from another party against the expense relating to the provision. An entity shall exclude gains from the expected disposal of assets from the measurement of a provision.

Subsequent measurement

20.10 An entity shall charge against a provision only those expenditures for which the provision was originally recognised.

20.11 An entity shall review provisions at each reporting date and adjust them to reflect the current best estimate of the amount that would be required to settle the obligation at that reporting date. Any adjustments to the amounts previously recognised shall be recognised in profit or loss unless the provision was originally recognised as part of the cost of inventories or property, plant and equipment (see paragraph 20.6). When a provision is measured at the present value of the amount expected to be required to settle the obligation, the unwinding of the discount shall be recognised as borrowing cost.

Contingent liabilities

20.12 A **contingent liability** is either a possible but uncertain obligation or a present obligation that is not recognised because it fails to meet one or both of the conditions (b) and (c) in paragraph 20.4. An entity shall not recognise a contingent liability as a liability, except for contingent liabilities of an acquiree in a business combination (see paragraphs 18.18 and 18.19). Disclosure may be required by paragraph 20.15.

Contingent assets

20.13 An entity shall not recognise a **contingent asset** as an asset. Disclosure may be required by paragraph 20.16.

Disclosures

Disclosures about provisions

20.14 For each class of provision, an entity shall disclose:

(a) the carrying amount at the beginning and end of the period.

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(b) additional provisions made in the period, including increases to existing provisions.

(c) amounts used (ie incurred and charged against the provision) during the period.

(d) unused amounts reversed during the period.

(e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate.

(f) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits.

(g) an indication of the uncertainties about the amount or timing of those outflows.

(h) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement.

Comparative information is not required.

Disclosures about contingent liabilities

20.15 Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the reporting date a brief description of the nature of the contingent liability and, when practicable:

(a) an estimate of its financial effect, measured in accordance with paragraphs 20.8–20.11;

(b) an indication of the uncertainties relating to the amount or timing of any outflow; and

(c) the possibility of any reimbursement.

If it is **impracticable** to make one or more of these disclosures, that fact shall be stated.

Disclosures about contingent assets

20.16 If an inflow of economic benefits is probable (more likely than not) but not virtually certain, an entity shall disclose a description of the nature of the **contingent assets** at the end of the **reporting period**, and, when

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practicable, an estimate of their financial effect, measured using the principles set out in paragraphs 20.8–20.11. If it is impracticable to make this disclosure, that fact shall be stated.

Prejudicial disclosures

20.17 In extremely rare cases, disclosure of some or all of the information required by paragraphs 20.14–20.16 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

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Appendix to Section 20
Guidance on implementing Section 20

This Appendix accompanies, but is not part of, Section 20. It provides guidance for applying the requirements of Section 20 in recognising and measuring provisions.

Example 1 Future operating losses

20A.1 An entity determines that it is probable that a segment of its operations will incur future operating losses for several years.

Present obligation as a result of a past obligating event—There is no past event that obligates the entity to pay out resources.

Conclusion—The entity does not recognise a provision for future operating losses. Expected future losses do not meet the definition of a liability. The expectation of future operating losses may be an indicator that one or more assets are impaired—see Section 26 *Impairment of Non-financial Assets*.

Example 2 Onerous contracts

20A.2 An onerous contract is one in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits expected to be received under it. For example, an entity may be obligated under an operating lease to make payments to lease an asset for which it no longer has any use.

Present obligation as a result of a past obligating event—The entity is contractually obligated to pay out resources for which it will not receive commensurate benefits.

Conclusion—If an entity has a contract that is onerous, the entity recognises and measures the present obligation under the contract as a provision.

Example 3 Restructurings

20A.3 A restructuring is a programme that is planned and controlled by management, and materially changes either:

(a) the scope of a business undertaken by an entity; or

(b) the manner in which that business is conducted.

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Present obligation as a result of a past obligating event—A constructive obligation to restructure arises only when an entity:

(a) has a detailed formal plan for the restructuring identifying at least:

  (i) the business or part of a business concerned;

  (ii) the principal locations affected;

  (iii) the location, function, and approximate number of employees who will be compensated for terminating their services;

  (iv) the expenditures that will be undertaken; and

  (v) when the plan will be implemented; and

(b) has raised a valid expectation in those affected that it will carry out the restructuring by starting to implement that plan or announcing its main features to those affected by it.

Conclusion—An entity recognises a provision for restructuring costs only when it has a legal or constructive obligation to carry out the restructuring.

Example 4 Warranties

20A.4 A manufacturer gives warranties at the time of sale to purchasers of its product. Under the terms of the contract for sale the manufacturer undertakes to make good, by repair or replacement, manufacturing defects that become apparent within three years from the date of sale. On past experience, it is probable (ie more likely than not) that there will be some claims under the warranties.

Present obligation as a result of a past obligating event—The obligating event is the sale of the product with a warranty, which gives rise to a legal obligation.

An outflow of resources embodying economic benefits in settlement—Probable for the warranties as a whole.

Conclusion—The entity recognises a provision for the best estimate of the costs of making good under the warranty products sold before the reporting date.

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Illustration of calculations:

In 20X0, goods are sold for 1,000,000. Experience indicates that 90 per cent of products sold require no warranty repairs; 6 per cent of products sold require minor repairs costing 30 per cent of the sale price; and 4 per cent of products sold require major repairs or replacement costing 70 per cent of sale price. Therefore estimated warranty costs are:

1,000,000 × 90% × 0 =	0
1,000,000 × 6% × 30% =	18,000
1,000,000 × 4% × 70% =	28,000
Total	46,000

The expenditures for warranty repairs and replacements for products sold in 20X0 are expected to be made 60 per cent in 20X1, 30 per cent in 20X2, and 10 per cent in 20X3. Because the estimated cash flows already reflect the probabilities of the cash outflows, and assuming there are no other risks or uncertainties that must be reflected, to determine the present value of those cash flows the entity uses a 'risk-free' discount rate based on government bonds with the same term as the expected cash outflows (6 per cent for one-year bonds and 7 per cent for two-year and three-year bonds). Calculation of the present value, at the end of 20X0, of the estimated cash flows related to the warranties for products sold in 20X0 is as follows:

Year		Expected cash payments	Discount rate	Discount factor	Present value
1	60% × 46,000	27,600	6%	0.9434 (at 6% for 1 year)	26,038
2	30% × 46,000	13,800	7%	0.8734 (at 7% for 2 years)	12,053
3	10% × 46,000	4,600	7%	0.8163 (at 7% for 3 years)	3,755
Total					41,846

The entity will recognise a warranty obligation of 41,846 at the end of 20X0 for products sold in 20X0.

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Example 5 Refunds policy

20A.5 A retail store has a policy of refunding purchases by dissatisfied customers, even though it is under no legal obligation to do so. Its policy of making refunds is generally known.

Present obligation as a result of a past obligating event—The obligating event is the sale of the product, which gives rise to a constructive obligation because the conduct of the store has created a valid expectation on the part of its customers that the store will refund purchases.

An outflow of resources embodying economic benefits in settlement—Probable that a proportion of goods will be returned for refund.

Conclusion—The entity recognises a provision for the best estimate of the amount required to settle the refunds.

Example 6 Closure of a division—no implementation before end of reporting period

20A.6 On 12 December 20X0 the board of an entity decided to close down a division. Before the end of the reporting period (31 December 20X0) the decision was not communicated to any of those affected and no other steps were taken to implement the decision.

Present obligation as a result of a past obligating event—There has been no obligating event, and so there is no obligation.

Conclusion—The entity does not recognise a provision.

Example 7 Closure of a division—communication and implementation before end of reporting period

20A.7 On 12 December 20X0, the board of an entity decided to close down a division making a particular product. On 20 December 20X0 a detailed plan for closing down the division was agreed by the board; letters were sent to customers warning them to seek an alternative source of supply and redundancy notices were sent to the staff of the division.

Present obligation as a result of a past obligating event—The obligating event is the communication of the decision to the customers and employees, which gives rise to a constructive obligation from that date, because it creates a valid expectation that the division will be closed.

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An outflow of resources embodying economic benefits in settlement—Probable.

Conclusion—The entity recognises a provision at 31 December 20X0 for the best estimate of the costs that would be incurred to close the division at the reporting date.

Example 8 Staff retraining as a result of changes in the income tax system

20A.8 The government introduces a number of changes to the income tax system. As a result of these changes, an entity in the financial services sector will need to retrain a large proportion of its administrative and sales workforce in order to ensure continued compliance with financial services regulation. At the end of the reporting period, no retraining of staff has taken place.

Present obligation as a result of a past obligating event—There is no obligation because no obligating event (retraining) has taken place.

Conclusion—The entity does not recognise a provision.

Example 9 A court case

20A.9 A customer has sued Entity X, seeking damages for injury the customer allegedly sustained from using a product sold by Entity X. Entity X disputes liability on grounds that the customer did not follow directions in using the product. Up to the date the board authorised the financial statements for the year to 31 December 20X1 for issue, the entity's lawyers advise that it is probable that the entity will not be found liable. However, when the entity prepares the financial statements for the year to 31 December 20X2, its lawyers advise that, owing to developments in the case, it is now probable that the entity will be found liable.

(a) At 31 December 20X1

Present obligation as a result of a past obligating event—On the basis of the evidence available when the financial statements were approved, there is no obligation as a result of past events.

Conclusion—No provision is recognised. The matter is disclosed as a contingent liability unless the probability of any outflow is regarded as remote.

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(b) At 31 December 20X2

Present obligation as a result of a past obligating event—On the basis of the evidence available, there is a present obligation.

An outflow of resources embodying economic benefits in settlement—Probable.

Conclusion—A provision is recognised for the best estimate of the amount to settle the obligation at the reporting date.

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Section 21
Equity

21.1 **Equity** is the residual interest in the assets of an entity after deducting all its liabilities. Equity includes investments by the owners of the entity, plus additions to those investments earned through profitable operations and retained for use in the entity's operations, minus reductions to owners' investments as a result of unprofitable operations and distributions to owners. This section addresses accounting for equity instruments issued to individuals or other parties acting in their capacity as investors in equity instruments. Section 25 *Share-based Payment* addresses accounting for a transaction in which the entity receives goods or services (including employee services) as consideration for its equity instruments (including shares or share options) from employees and other vendors acting in their capacity as vendors of goods and services.

Original issue of shares or other equity instruments

21.2 An entity shall recognise the issue of shares or other equity instruments as equity when it issues those instruments and another party is obliged to provide cash or other resources to the entity in exchange for the instruments.

(a) If the instruments are issued before the cash or other resources are provided, the entity shall present the amount receivable as an offset to equity in its balance sheet, not as an asset.

(b) If the cash or other resources are received before the instruments are issued, and the entity cannot be required to repay the cash or other resources received, the entity shall recognise the corresponding increase in equity to the extent of consideration received.

(c) To the extent that instruments have been subscribed for but cash or other resources have not yet been provided, the entity shall not recognise an increase in equity.

21.3 An entity shall measure the equity instruments at the fair value of the cash or other resources received or receivable, net of direct costs of issuing the equity instruments. If payment is deferred and the time value of money is significant, the initial measurement shall be on a **present value** basis.

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21.4 How the increase in equity arising on the issuance of shares or other equity instruments is presented in the balance sheet is determined by applicable laws. For example, the par value (or other nominal value) of shares and the amount paid in excess of par value may be presented separately.

Sale of options, rights, and warrants

21.5 An entity shall apply the principles in paragraphs 21.2 and 21.3 to equity issued by means of sales of options, rights, warrants, and similar equity instruments.

Capitalisation or bonus issues of shares and share splits

21.6 A capitalisation or bonus issue (sometimes referred to as a stock dividend) is the issue of new shares to shareholders in proportion to their existing holdings. For example, an entity may give its shareholders one dividend or bonus share for every five shares held. A share split (sometimes referred to as a stock split) is the dividing of an entity's existing shares into multiple shares. For example, in a 2-for-1 split, each shareholder receives one additional share for each share held. In some cases, the previously outstanding shares are cancelled and replaced by new shares. Capitalisation and bonus issues and share splits do not change total equity. An entity shall reclassify amounts within equity as required by applicable laws.

Issuance of compound financial instruments

21.7 On issuing convertible debt or similar compound **financial instruments** that contain both a **liability** and an equity component, an entity shall allocate the proceeds between the liability component and the equity component. To make the allocation, the entity shall first determine the amount of the liability component as the fair value of a similar liability that does not have an associated equity component. The entity shall allocate the residual amount as the equity component.

21.8 The entity shall not revise the allocation in a subsequent period.

21.9 In periods after the instruments were issued, the entity shall systematically recognise any difference between the liability component and the principal amount payable at maturity as additional interest expense using the **effective interest method**.

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Treasury shares

21.10 **Treasury shares** are the equity instruments of an entity that have been acquired or reacquired by the entity. An entity shall deduct from equity the fair value of the consideration given for the treasury shares. The entity shall not recognise a gain or loss in profit or loss on the purchase, sale, issue or cancellation of treasury shares.

Minority interest and transactions in shares of a consolidated subsidiary

21.11 In consolidated financial statements, a **minority interest** (ie non-controlling interest) in the net assets of a subsidiary is included in equity. An entity shall treat changes in a parent's controlling interest in a subsidiary that do not result in a loss of **control** as transactions with equity holders in their capacity as equity holders. An entity shall not recognise gain or loss on these changes in consolidated profit or loss. Also, an entity shall not recognise any change in the **carrying amounts** of assets (including goodwill) or liabilities as a result of such transactions.

Disclosure

21.12 Paragraph 4.13(a)(iv) requires an entity with share capital to disclose, either on the face of the balance sheet or in the notes, for each class of share capital, a reconciliation of the number of shares outstanding (or other measure of quantity) at the beginning and at the end of the period. In that reconciliation, the entity shall identify separately each significant type of change in the number of shares outstanding, including new issues; exercises of options, rights and warrants; conversions of convertible securities; treasury share transactions; **business combinations**; and bonus issues (share dividends) and share splits.

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Section 22
Revenue

22.1 This section shall be applied in accounting for **revenue** arising from the following transactions and events:

(a) the sale of goods (whether produced by the entity for the purpose of sale or purchased for resale);

(b) the rendering of services; and

(c) the use by others of entity assets yielding interest, royalties or dividends.

22.2 Revenue arising from some transactions and events is dealt with in other sections of this [draft] standard:

(a) lease agreements (see Section 19 *Leases*);

(b) dividends arising from investments that are accounted for using the equity method (see Section 13 *Investments in Associates* and Section 14 *Investments in Joint Ventures*);

(c) changes in the **fair value** of **financial assets** and **financial liabilities** or their disposal (see Section 11 *Financial Assets and Financial Liabilities*);

(d) initial **recognition** and changes in the fair value of **biological assets** related to agricultural activity (see Section 35 *Specialised Industries*); and

(e) initial recognition of **agricultural produce** (see Section 35).

Measurement of revenue

22.3 An entity shall measure revenue at the fair value of the consideration received or receivable. The fair value of the consideration received or receivable excludes the amount of any trade discounts and volume rebates allowed by the entity.

22.4 An entity shall include in revenue only the gross inflows of economic benefits received and receivable by the entity on its own account. An entity shall exclude from revenue all amounts collected on behalf of third parties such as sales taxes, goods and services taxes and value added

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taxes. In an agency relationship, an entity shall include in revenue only the amount of commission. The amounts collected on behalf of the principal are not revenue of the entity.

Deferred payment

22.5 When the inflow of cash or cash equivalents is deferred, and the arrangement constitutes in effect a financing transaction, the fair value of the consideration is the **present value** of all future receipts determined using an **imputed rate of interest**. A financing transaction arises when, for example, an entity provides interest free credit to the buyer or accepts a note receivable bearing a below market interest rate from the buyer as consideration for the sale of goods. The imputed rate of interest is the more clearly determinable of either:

(a) the prevailing rate for a similar instrument of an issuer with a similar credit rating; or

(b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

An entity shall recognise the difference between the present value of all future receipts and the nominal amount of the consideration as interest revenue in accordance with paragraphs 22.15 and 22.16 and Section 11.

Exchanges of goods or services

22.6 An entity shall not recognise revenue when goods or services are exchanged or swapped for goods or services that are of a similar nature and value. However, an entity shall recognise revenue when goods are sold or services are rendered in exchange for dissimilar goods or services. In this case, the entity shall measure the transaction at fair value unless (a) the exchange transaction lacks commercial substance or (b) the fair value of neither the asset received nor the asset given up is reliably measurable. If the transaction cannot be measured at fair value, then the entity shall measure it at the **carrying amount** of the asset given up.

Identification of the revenue transaction

22.7 An entity usually applies the revenue recognition criteria in this section separately to each transaction. However, an entity applies the recognition criteria to the separately identifiable components of a single transaction when necessary to reflect the substance of the transaction.

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For example, an entity applies the recognition criteria to the separately identifiable components of a single transaction when the selling price of a product includes an identifiable amount for subsequent servicing. Conversely, an entity applies the recognition criteria to two or more transactions together when they are linked in such a way that the commercial effect cannot be understood without reference to the series of transactions as a whole. For example, an entity applies the recognition criteria to two or more transactions together when it sells goods and, at the same time, enters into a separate agreement to repurchase the goods at a later date, thus negating the substantive effect of the transaction.

Sale of goods

22.8 An entity shall recognise revenue from the sale of goods when all the following conditions are satisfied:

(a) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods;

(b) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective **control** over the goods sold;

(c) the amount of revenue can be measured reliably;

(d) it is **probable** that the economic benefits associated with the transaction will flow to the entity; and

(e) the costs incurred or to be incurred in respect of the transaction can be measured reliably.

22.9 The assessment of when an entity has transferred the significant risks and rewards of ownership to the buyer requires an examination of the circumstances of the transaction. In most cases, the transfer of the risks and rewards of ownership coincides with the transfer of the legal title or the passing of possession to the buyer. This is the case for most retail sales. In other cases, the transfer of risks and rewards of ownership occurs at a time different from the transfer of legal title or the passing of possession.

22.10 The entity does not recognise revenue if it retains significant risks of ownership. Examples of situations in which the entity may retain the significant risks and rewards of ownership are:

(a) when the entity retains an obligation for unsatisfactory performance not covered by normal warranty **provisions**;

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(b) when the receipt of the revenue from a particular sale is contingent on the buyer selling the goods;

(c) when the goods are shipped subject to installation and the installation is a significant part of the contract that has not yet been completed; and

(d) when the buyer has the right to rescind the purchase for a reason specified in the sales contract and the entity is uncertain about the probability of return.

22.11 If an entity retains only an insignificant risk of ownership, the transaction is a sale and the entity recognises the revenue. For example, a seller recognises revenue when it retains the legal title to the goods solely to protect the collectibility of the amount due. Similarly an entity recognises revenue when it offers a refund if the customer is not satisfied. In such cases, the entity recognises a provision for returns in accordance with Section 20 *Provisions and Contingencies*.

Rendering of services

22.12 When the outcome of a transaction involving the rendering of services can be estimated reliably, an entity shall recognise revenue associated with the transaction by reference to the stage of completion of the transaction at the end of the **reporting period** (sometimes referred to as the percentage of completion method). The outcome of a transaction can be estimated reliably when all the following conditions are satisfied:

(a) the amount of revenue can be measured reliably;

(b) it is probable that the economic benefits associated with the transaction will flow to the entity;

(c) the stage of completion of the transaction at the end of the reporting period can be measured reliably; and

(d) the costs incurred for the transaction and the costs to complete the transaction can be measured reliably.

Paragraphs 22.21–22.27 provide guidance for applying the percentage of completion method.

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22.13 When services are performed by an indeterminate number of acts over a specified period of time, an entity recognises revenue on a straight-line basis over the specified period unless there is evidence that some other method better represents the stage of completion. When a specific act is more significant than any other act, the entity postpones recognition of revenue until the significant act is executed.

22.14 When the outcome of the transaction involving the rendering of services cannot be estimated reliably, an entity shall recognise revenue only to the extent of the expenses recognised that are recoverable.

Interest, royalties and dividends

22.15 An entity shall recognise revenue arising from the use by others of entity assets yielding interest, royalties and dividends on the bases set out in paragraph 22.16 when:

(a) it is probable that the economic benefits associated with the transaction will flow to the entity; and

(b) the amount of the revenue can be measured reliably.

22.16 An entity shall recognise revenue on the following bases:

(a) interest shall be recognised using the **effective interest method** as described in Appendix A of Section 11;

(b) royalties shall be recognised on an accrual basis in accordance with the substance of the relevant agreement; and

(c) dividends shall be recognised when the shareholder's right to receive payment is established.

Construction contracts

22.17 When the outcome of a **construction contract** can be estimated reliably, an entity shall recognise contract revenue and contract costs associated with the construction contract as revenue and expenses respectively by reference to the stage of completion of the contract activity at the end of the reporting period (often referred to as the percentage of completion method). Reliable estimation of the outcome requires reliable estimates of the stage of completion, future costs and collectibility of billings. Paragraphs 22.21–22.27 provide guidance for applying the percentage of completion method.

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22.18 The requirements of this section are usually applied separately to each construction contract. However, in some circumstances, it is necessary to apply this section to the separately identifiable components of a single contract or to a group of contracts together in order to reflect the substance of a contract or a group of contracts.

22.19 When a contract covers a number of assets, the construction of each asset shall be treated as a separate construction contract when:

(a) separate proposals have been submitted for each asset;

(b) each asset has been subject to separate negotiation and the contractor and customer have been able to accept or reject that part of the contract relating to each asset; and

(c) the costs and revenues of each asset can be identified.

22.20 A group of contracts, whether with a single customer or with several customers, shall be treated as a single construction contract when:

(a) the group of contracts is negotiated as a single package;

(b) the contracts are so closely interrelated that they are, in effect, part of a single project with an overall profit margin; and

(c) the contracts are performed concurrently or in a continuous sequence.

Percentage of completion method

22.21 An entity shall review and, when necessary, revise the estimates of revenue and costs as the service transaction or construction contract progresses.

22.22 An entity shall determine the stage of completion of a transaction or contract using the method that measures most reliably the work performed. Possible methods include:

(a) the proportion that costs incurred for work performed to date bear to the estimated total costs. Costs incurred for work performed to date do not include costs relating to future activity, such as for materials or prepayments;

(b) surveys of work performed; or

(c) completion of a physical proportion of the service transaction or contract work.

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Progress payments and advances received from customers often do not reflect the work performed.

22.23 An entity shall recognise costs that relate to future activity on the transaction or contract, such as for materials or prepayments, as an asset if it is probable that the costs will be recovered. Such costs represent an amount due from the customer and are classified as work in progress.

22.24 An entity shall recognise as an expense immediately any costs that are not probable of being recovered.

22.25 When the outcome of a construction contract cannot be estimated reliably:

(a) an entity shall recognise revenue only to the extent of contract costs incurred that it is probable will be recoverable; and

(b) the entity shall recognise contract costs as an expense in the period in which they are incurred.

22.26 When it is probable that total contract costs will exceed total contract revenue on a construction contract, the expected loss shall be recognised as an expense immediately.

22.27 If the collectibility of an amount already recognised as contract revenue is no longer probable, the entity shall recognise the uncollectible amount as an expense rather than as an adjustment of the amount of contract revenue.

Disclosure

General disclosures relating to revenue

22.28 An entity shall disclose:

(a) the **accounting policies** adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services;

(b) the amount of each category of revenue recognised during the period, including revenue arising from:

(i) the sale of goods;

(ii) the rendering of services;

(iii) interest;

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(iv) royalties;

(v) dividends; and

(c) the amount of revenue arising from exchanges of goods or services included in each category of revenue.

Disclosures relating to revenue from construction contracts

22.29 An entity shall disclose:

(a) the amount of contract revenue recognised as revenue in the period;

(b) the methods used to determine the contract revenue recognised in the period; and

(c) the methods used to determine the stage of completion of contracts in progress.

22.30 An entity shall disclose each of the following for contracts in progress at the **reporting date**:

(a) the aggregate amount of costs incurred and recognised profits (less recognised losses) to date;

(b) the amount of advances received; and

(c) the amount of retentions (progress billings that are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified).

22.31 An entity shall present:

(a) the gross amount due from customers for contract work, as an asset; and

(b) the gross amount due to customers for contract work, as a liability.

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Appendix to Section 22
Examples of revenue recognition under the principles in Section 22

This Appendix accompanies, but is not part of, Section 22. It provides guidance for applying the requirements of Section 22 in recognising and measuring revenue.

22A.1 The following examples focus on particular aspects of a transaction and are not a comprehensive discussion of all the relevant factors that might influence the recognition of revenue. The examples generally assume that the amount of revenue can be measured reliably, it is probable that the economic benefits will flow to the entity and the costs incurred or to be incurred can be measured reliably.

Sale of goods

22A.2 The law in different countries may cause the recognition criteria in Section 22 to be met at different times. In particular, the law may determine the point in time at which the entity transfers the significant risks and rewards of ownership. Therefore, the examples in this appendix need to be read in the context of the laws relating to the sale of goods in the country in which the transaction takes place.

Example 1 'Bill and hold' sales, in which delivery is delayed at the buyer's request but the buyer takes title and accepts billing

22A.3 The seller recognises revenue when the buyer takes title, provided:

(a) it is probable that delivery will be made;

(b) the item is on hand, identified and ready for delivery to the buyer at the time the sale is recognised;

(c) the buyer specifically acknowledges the deferred delivery instructions; and

(d) the usual payment terms apply.

Revenue is not recognised when there is simply an intention to acquire or manufacture the goods in time for delivery.

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Example 2 Goods shipped subject to conditions: installation and inspection

22A.4 The seller normally recognises revenue when the buyer accepts delivery, and installation and inspection are complete. However, revenue is recognised immediately upon the buyer's acceptance of delivery when:

(a) the installation process is simple, for example the installation of a factory-tested television receiver that requires only unpacking and connection of power and antennae; or

(b) the inspection is performed only for the purposes of final determination of contract prices, for example, shipments of iron ore, sugar or soya beans.

Example 3 Goods shipped subject to conditions: on approval when the buyer has negotiated a limited right of return

22A.5 If there is uncertainty about the possibility of return, the seller recognises revenue when the shipment has been formally accepted by the buyer or the goods have been delivered and the time period for rejection has elapsed.

Example 4 Goods shipped subject to conditions: consignment sales under which the recipient (buyer) undertakes to sell the goods on behalf of the shipper (seller)

22A.6 The shipper recognises revenue when the goods are sold by the recipient to a third party.

Example 5 Goods shipped subject to conditions: cash on delivery sales

22A.7 The seller recognises revenue when delivery is made and cash is received by the seller or its agent.

Example 6 Layaway sales under which the goods are delivered only when the buyer makes the final payment in a series of instalments

22A.8 The seller recognises revenue from such sales when the goods are delivered. However, when experience indicates that most such sales are consummated, revenue may be recognised when a significant deposit is received, provided the goods are on hand, identified and ready for delivery to the buyer.

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Example 7 Orders when payment (or partial payment) is received in advance of delivery for goods not currently held in inventory, for example, the goods are still to be manufactured or will be delivered direct to the customer from a third party

22A.9 The seller recognises revenue when the goods are delivered to the buyer.

Example 8 Sale and repurchase agreements (other than swap transactions) under which the seller concurrently agrees to repurchase the same goods at a later date, or when the seller has a call option to repurchase, or the buyer has a put option to require the repurchase, by the seller, of the goods

22A.10 For a sale and repurchase agreement on an asset other than a financial asset, the seller must analyse the terms of the agreement to ascertain whether, in substance, the risks and rewards of ownership have been transferred to the buyer. If they have been transferred, the seller recognises revenue. When the seller has retained the risks and rewards of ownership, even though legal title has been transferred, the transaction is a financing arrangement and does not give rise to revenue. For a sale and repurchase agreement on a financial asset, Section 11 applies.

Example 9 Sales to intermediate parties, such as distributors, dealers or others for resale

22A.11 The seller generally recognises revenue from such sales when the risks and rewards of ownership have passed. However, when the buyer is acting, in substance, as an agent, the sale is treated as a consignment sale.

Example 10 Subscriptions to publications and similar items

22A.12 When the items involved are of similar value in each time period, the seller recognises revenue on a straight-line basis over the period in which the items are despatched. When the items vary in value from period to period, the seller recognises revenue on the basis of the sales value of the item despatched in relation to the total estimated sales value of all items covered by the subscription.

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Example 11 Instalment sales, under which the consideration is receivable in instalments

22A.13 The seller recognises revenue attributable to the sales price, exclusive of interest, at the date of sale. The sale price is the present value of the consideration, determined by discounting the instalments receivable at the imputed rate of interest. The seller recognises the interest element as revenue using the effective interest method.

Example 12 Real estate sales

22A.14 The seller normally recognises revenue when legal title passes to the buyer. However, in some jurisdictions the equitable interest in a property may vest in the buyer before legal title passes and, therefore, the risks and rewards of ownership have been transferred at that stage. In such cases, provided that the seller has no further substantial acts to complete under the contract, it may be appropriate to recognise revenue. In either case, if the seller is obliged to perform any significant acts after the transfer of the equitable and/or legal title, revenue is recognised as the acts are performed. An example is a building or other facility on which construction has not been completed.

22A.15 In some cases, real estate may be sold with such a degree of continuing involvement by the seller that the risks and rewards of ownership have not been transferred. Examples are sale and repurchase agreements that include put and call options, and agreements whereby the seller guarantees occupancy of the property for a specified period, or guarantees a return on the buyer's investment for a specified period. In such cases, the nature and extent of the seller's continuing involvement determines how the transaction is accounted for. It may be accounted for as a sale, or as a financing, leasing or some other profit-sharing arrangement. If it is accounted for as a sale, the continuing involvement of the seller may delay the recognition of revenue.

22A.16 A seller also considers the means of payment and evidence of the buyer's commitment to complete payment. For example, when the aggregate of the payments received, including the buyer's initial down payment, or continuing payments by the buyer, provide insufficient evidence of the buyer's commitment to complete payment, the seller recognises revenue only to the extent cash is received.

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Rendering of services

Example 13 Installation fees

22A.17 The seller recognises installation fees as revenue by reference to the stage of completion of the installation, unless they are incidental to the sale of a product, in which case they are recognised when the goods are sold.

Example 14 Servicing fees included in the price of the product

22A.18 When the selling price of a product includes an identifiable amount for subsequent servicing (for example, after sales support and product enhancement on the sale of software), the seller defers that amount and recognises it as revenue over the period during which the service is performed. The amount deferred is that which will cover the expected costs of the services under the agreement, together with a reasonable profit on those services.

Example 15 Advertising commissions

22A.19 Media commissions are recognised when the related advertisement or commercial appears before the public. Production commissions are recognised by reference to the stage of completion of the project.

Example 16 Insurance agency commissions

22A.20 Insurance agency commissions received or receivable that do not require the agent to render further service are recognised as revenue by the agent on the effective commencement or renewal dates of the related policies. However, when it is probable that the agent will be required to render further services during the life of the policy, the agent defers the commission, or part of it, and recognises it as revenue over the period during which the policy is in force.

Example 17 Admission fees

22A.21 The seller recognises revenue from artistic performances, banquets and other special events when the event takes place. When a subscription to a number of events is sold, the seller allocates the fee to each event on a basis that reflects the extent to which services are performed at each event.

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Example 18 Tuition fees

22A.22 The seller recognises revenue over the period of instruction.

Example 19 Initiation, entrance and membership fees

22A.23 Revenue recognition depends on the nature of the services provided. If the fee permits only membership, and all other services or products are paid for separately, or if there is a separate annual subscription, the fee is recognised as revenue when no significant uncertainty about its collectibility exists. If the fee entitles the member to services or publications to be provided during the membership period, or to purchase goods or services at prices lower than those charged to non-members, it is recognised on a basis that reflects the timing, nature and value of the benefits provided.

Franchise fees

22A.24 Franchise fees may cover the supply of initial and subsequent services, equipment and other tangible assets, and know how. Accordingly, franchise fees are recognised as revenue on a basis that reflects the purpose for which the fees were charged. The following methods of franchise fee recognition are appropriate.

Example 20 Franchise fees: Supplies of equipment and other tangible assets

22A.25 The franchisor recognises the fair value of the assets sold as revenue when the items are delivered or title passes.

Example 21 Franchise fees: Supplies of initial and subsequent services

22A.26 The franchisor recognises fees for the provision of continuing services, whether part of the initial fee or a separate fee, as revenue as the services are rendered. When the separate fee does not cover the cost of continuing services together with a reasonable profit, part of the initial fee, sufficient to cover the costs of continuing services and to provide a reasonable profit on those services, is deferred and recognised as revenue as the services are rendered.

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22A.27 The franchise agreement may provide for the franchisor to supply equipment, inventories, or other tangible assets, at a price lower than that charged to others or a price that does not provide a reasonable profit on those sales. In these circumstances, part of the initial fee, sufficient to cover estimated costs in excess of that price and to provide a reasonable profit on those sales, is deferred and recognised over the period the goods are likely to be sold to the franchisee. The balance of an initial fee is recognised as revenue when performance of all the initial services and other obligations required of the franchisor (such as assistance with site selection, staff training, financing and advertising) has been substantially accomplished.

22A.28 The initial services and other obligations under an area franchise agreement may depend on the number of individual outlets established in the area. In this case, the fees attributable to the initial services are recognised as revenue in proportion to the number of outlets for which the initial services have been substantially completed.

22A.29 If the initial fee is collectible over an extended period and there is a significant uncertainty that it will be collected in full, the fee is recognised as cash instalments are received.

Example 22 Franchise fees: Continuing franchise fees

22A.30 Fees charged for the use of continuing rights granted by the agreement, or for other services provided during the period of the agreement, are recognised as revenue as the services are provided or the rights used.

Example 23 Franchise fees: Agency transactions

22A.31 Transactions may take place between the franchisor and the franchisee that, in substance, involve the franchisor acting as agent for the franchisee. For example, the franchisor may order supplies and arrange for their delivery to the franchisee at no profit. Such transactions do not give rise to revenue.

Example 24 Fees from the development of customised software

22A.32 The software developer recognises fees from the development of customised software as revenue by reference to the stage of completion of the development, including completion of services provided for post-delivery service support.

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Interest, royalties and dividends

Example 25 Licence fees and royalties

22A.33 The licensor recognises fees and royalties paid for the use of an entity's assets (such as trademarks, patents, software, music copyright, record masters and motion picture films) in accordance with the substance of the agreement. As a practical matter, this may be on a straight-line basis over the life of the agreement, for example, when a licensee has the right to use certain technology for a specified period of time.

22A.34 An assignment of rights for a fixed fee or non-refundable guarantee under a non-cancellable contract that permits the licensee to exploit those rights freely and the licensor has no remaining obligations to perform is, in substance, a sale. An example is a licensing agreement for the use of software when the licensor has no obligations after delivery. Another example is the granting of rights to exhibit a motion picture film in markets where the licensor has no control over the distributor and expects to receive no further revenues from the box office receipts. In such cases, revenue is recognised at the time of sale.

22A.35 In some cases, whether or not a licence fee or royalty will be received is contingent on the occurrence of a future event. In such cases, revenue is recognised only when it is probable that the fee or royalty will be received, which is normally when the event has occurred.

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Section 23
Government Grants

23.1 A **government grant** is assistance by government in the form of a transfer of resources to an entity in return for past or future compliance with specified conditions relating to the operating activities of the entity.

23.2 Government grants exclude those forms of government assistance that cannot reasonably have a value placed upon them and transactions with government that cannot be distinguished from the normal trading transactions of the entity.

Recognition and measurement—accounting policy election

23.3 An entity shall account for its government grants using either:

(a) the *IFRS for SMEs* model in paragraph 23.4 for all government grants; or

(b) the *IFRS for SMEs* model in paragraph 23.4 for those government grants related to assets measured at **fair value** through profit or loss and IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* for all other grants.

IFRS for SMEs model

23.4 An entity shall recognise government grants as follows:

(a) a grant that does not impose specified future performance conditions on the recipient is recognised in income when the grant proceeds are receivable;

(b) a grant that imposes specified future performance conditions on the recipient is recognised in income only when the performance conditions are met;

(c) grants received before the income recognition criteria are satisfied are recognised as a liability.

23.5 An entity shall measure grants at the fair value of the asset received or receivable.

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Disclosure

23.6 An entity shall disclose the following regardless of which choice it has made under paragraph 23.3:

(a) the **accounting policy** adopted for government grants, including an explanation of how the grant is presented in the **financial statements**;

(b) the nature and amounts of government grants recognised in the financial statements;

(c) unfulfilled conditions and other contingencies attaching to government grants that have not been recognised in income; and

(d) an indication of other forms of government assistance from which the entity has directly benefited.

23.7 For the purpose of the disclosure required by paragraph 23.6(d), government assistance is action by government designed to provide an economic benefit specific to an entity or range of entities qualifying under specified criteria. Examples include free technical or marketing advice, the provision of guarantees, and loans at nil or low interest rates.

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Section 24
Borrowing Costs

24.1 Borrowing costs are interest and other costs arising on an entity's financial liabilities. Borrowing costs include:

(a) interest on bank overdrafts and short-term and long-term borrowings;

(b) amortisation of discounts or premiums relating to borrowings;

(c) amortisation of ancillary costs incurred in connection with the arrangement of borrowings;

(d) finance charges in respect of finance leases recognised in accordance with Section 19 *Leases*; and

(e) exchange differences arising from foreign currency borrowings to the extent that they are regarded as an adjustment to interest costs.

Recognition—accounting policy election

24.2 An entity shall account for all of its borrowing costs using either:

(a) the expense model in paragraph 24.3; or

(b) the capitalisation model in paragraph 24.4.

Expense model

24.3 An entity shall recognise all borrowing costs as an expense in profit or loss in the period in which they are incurred.

Capitalisation model

24.4 An entity that elects to use the capitalisation model shall apply IAS 23 *Borrowing Costs*.

Disclosure

24.5 An entity shall disclose the **accounting policy** adopted for borrowing costs. If the capitalisation model is adopted as provided in paragraph 24.4, the entity shall include the relevant disclosures required by IAS 23.

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Section 25
Share-based Payment

25.1 An entity shall apply this section in accounting for all **share-based payment transactions** including:

(a) **equity-settled share-based payment** transactions, in which the entity receives goods or services as consideration for **equity** instruments of the entity (including shares or share options),

(b) **cash-settled share-based payment** transactions, in which the entity acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity, and

(c) transactions in which the entity receives or acquires goods or services and the terms of the arrangement provide either the entity or the supplier of those goods or services with a choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments.

Recognition

25.2 An entity shall recognise the goods or services received or acquired in a share-based payment transaction when it obtains the goods or as the services are received. The entity shall recognise a corresponding increase in equity if the goods or services were received in an equity-settled share-based payment transaction, or a liability if the goods or services were acquired in a cash-settled share-based payment transaction.

25.3 When the goods or services received or acquired in a share-based payment transaction do not qualify for recognition as assets, the entity shall recognise them as expenses.

Measurement of equity-settled share-based payment transactions

25.4 An entity shall apply IFRS 2 *Share-based Payment* in measuring equity-settled share-based payment transactions, and shall make the relevant disclosures required by IFRS 2. For equity-settled share-based payment transactions with employees, IFRS 2 generally requires

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measurement by reference to the **fair value** of the equity instruments granted. However, if the entity is unable to estimate reliably the fair value of the equity instruments granted at the measurement date, IFRS 2 provides for measurement of the equity instruments at their **intrinsic value**, which is the difference between the fair value of the shares and the price, if any, that the counterparty is, or will be, required to pay for those shares. Intrinsic value is measured initially at the **grant date** and subsequently at each **reporting date** and at the date of final settlement, with any change in intrinsic value recognised in profit or loss.

Cash-settled share-based payment transactions

25.5 For cash-settled share-based payment transactions, an entity shall measure the goods or services acquired and the liability incurred at the fair value of the liability. Until the liability is settled, the entity shall remeasure the fair value of the liability at each reporting date and at the date of settlement, with any changes in fair value recognised in profit or loss for the period.

25.6 For transactions with employees, if the equity instruments granted do not vest until the employees have completed a specified period of service, the entity shall recognise the services received as the employees render service during that period.

Share-based payment transactions with cash alternatives

25.7 For share-based payment transactions in which the terms of the arrangement provide either the entity or the counterparty with the choice of whether the entity settles the transaction in cash (or other assets) or by issuing equity instruments, the entity shall account for that transaction, or the components of that transaction, as a cash-settled share-based payment transaction if, and to the extent that, the entity has incurred a liability to settle in cash or other assets, or as an equity-settled share-based payment transaction if, and to the extent that, no such liability has been incurred. An entity shall apply the procedures in IFRS 2 paragraphs 35–43 for measuring share-based payment transactions with cash alternatives.

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Disclosure

25.8 An entity shall disclose a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (eg whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information.

25.9 An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its **financial position**, including at least the following:

(a) the total expense recognised for the period arising from share-based payment transactions in which the goods or services received did not qualify for recognition as assets and hence were recognised immediately as an expense, including separate disclosure of that portion of the total expense that arises from transactions accounted for as equity-settled share-based payment transactions;

(b) with respect to liabilities arising from share-based payment transactions:

(i) the total **carrying amount** at the end of the period; and

(ii) the total intrinsic value at the end of the period of liabilities for which the counterparty's right to cash or other assets had vested by the end of the period (eg vested share appreciation rights).

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Section 26
Impairment of Non-financial Assets

26.1 This section shall be applied in accounting for the **impairment** of all assets, other than the following, for which other sections of this [draft] standard establish requirements for recognition of impairment:

(a) **deferred tax assets** (see Section 28 *Income Taxes*).

(b) assets arising from **employee benefits** (see Section 27 *Employee Benefits*).

(c) **financial assets** within the scope of Section 11 *Financial Assets and Financial Liabilities*.

(d) **investment property** measured at **fair value** (see Section 15 *Investment Property*).

(e) **biological assets** related to agricultural activity measured at fair value less estimated costs to sell (see Section 35 *Specialised Industries*).

Impairment of inventories

Selling price less costs to complete and sell

26.2 An entity shall assess at each **reporting date** whether any inventories are impaired. The entity shall make the assessment by comparing the **carrying amount** of each item of inventory (or group of similar items—see paragraph 26.3) with its selling price less costs to complete and sell. If an item of inventory (or group) is impaired, the entity shall recognise a loss in profit or loss for the difference between carrying amount and the selling price less costs to complete and sell.

26.3 If it is **impracticable** to determine the selling price less costs to complete and sell for inventories item by item, the entity may group items of inventory relating to the same product line that have similar purposes or end uses, are produced and marketed in the same geographical area for the purpose of assessing impairment.

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Reversal of impairment

26.4 An entity shall make a new assessment of selling price less costs to complete and sell in each subsequent period. When the circumstances that previously caused inventories to be impaired no longer exist or when there is clear evidence of an increase in selling price less costs to complete and sell because of changed economic circumstances, the entity shall reverse the amount of the impairment (ie the reversal is limited to the amount of the original impairment loss) so that the new carrying amount is the lower of the cost and the revised selling price less costs to complete and sell.

Impairment of non-financial assets other than inventories

Indicators of impairment

26.5 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 fair value less costs to sell of the asset. If there is no indication of impairment, it is not necessary to estimate the fair value less costs to sell. This section uses the term 'an asset' but sometimes fair value less costs to sell must be estimated for a group of assets (see paragraph 26.9).

26.6 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 materially the discount rate used in calculating an asset's value in use and decrease the asset's fair value less costs to sell.

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(d) the carrying amount of the net assets of the entity is more than its market capitalisation.

Internal sources of information

(e) evidence is available of obsolescence or physical damage of an asset.

(f) 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 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.

(g) evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected. In this context economic performance includes operating results and cash flows.

26.7 If there is an indication that an asset may be impaired, this may indicate that the entity should review the remaining useful life, the **depreciation (amortisation)** method or the **residual value** for the asset and adjust it in accordance with the section of this [draft] standard applicable to the asset (eg Section 16 *Property, Plant and Equipment* and Section 17 *Intangible Assets other than Goodwill*), even if no impairment loss is recognised for the asset.

Measuring fair value less costs to sell

26.8 Fair value less costs to sell is the amount obtainable from the sale of an asset or group of assets in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

26.9 If an entity cannot estimate fair value for an individual asset, the entity shall measure the fair value less costs to sell for the group of assets to which the asset belongs. For this purpose, fair value less costs to sell shall be estimated for the smallest identifiable group of assets

(a) that includes the asset for which impairment is indicated and

(b) whose fair value less costs to sell can be estimated.

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Fair value less costs to sell

26.10 An entity shall determine fair value less costs to sell on the basis of the following hierarchy of reliability of evidence:

(a) A price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.

(b) 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—usually based on the current bid price.

(c) 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.

(d) If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the end of the **reporting period**, 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, unless management is compelled to sell immediately.

26.11 When the fair value less costs to sell of an asset (or a group of assets—see paragraph 26.9) is less than its carrying amount, the entity shall reduce the carrying amount of the asset to its fair value less costs to sell. That reduction is an impairment loss.

26.12 An entity shall recognise an impairment loss immediately in profit or loss.

26.13 When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognise a liability only if that is required by this [draft] standard (see especially Section 20 *Provisions and Contingencies*).

26.14 After the recognition of an impairment loss, the depreciation (amortisation) 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.

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Reversal of an impairment loss

26.15 An entity shall assess at each reporting date whether there is any indication that an impairment loss recognised in prior periods for an asset other than goodwill may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the fair value less costs to sell of that asset. Indications that an impairment loss may have decreased or may no longer exist are generally the opposite of those set out in paragraph 26.6.

26.16 If the estimated fair value less costs to sell exceeds the carrying amount of the asset, the entity shall increase the carrying amount to fair value less costs to sell, subject to the limitation described in paragraph 26.17. That increase is a reversal of an impairment loss.

26.17 The increased carrying amount of an asset other than goodwill attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortisation or depreciation) had no impairment loss been recognised for the asset in prior years.

26.18 An entity shall recognise a reversal of an impairment loss for an asset other than goodwill immediately in profit or loss, unless the asset is carried at revalued amount in accordance with another section of this [draft] standard (for example, the revaluation model in Section 16). Any reversal of an impairment loss of a revalued asset shall be treated as a revaluation increase in accordance with the revaluation model.

26.19 After a reversal of an impairment loss is recognised, the depreciation (amortisation) 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.

Additional requirements for impairment of goodwill

26.20 Goodwill, by itself, cannot be sold. Nor does it generate cash flows to an entity that are independent of the cash flows of other assets. As a consequence, the fair value of goodwill cannot be measured directly. Therefore, the fair value of goodwill must be derived from measurement of the fair value of the larger group of assets of which the goodwill is a part.

26.21 The principles in paragraphs 26.5–26.14 for recognising and measuring impairment of assets apply to goodwill. Therefore, at each reporting date the entity shall assess whether there is any indication that goodwill may

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be impaired. In addition to considering the indicators of impairment in paragraph 26.6, the entity shall also consider whether:

(a) since acquisition, the acquired entity to which the goodwill relates has performed significantly worse than expected;

(b) the acquired entity to which the goodwill relates is being restructured, held for sale or abandoned; or

(c) significant impairment losses have been recognised for other assets of the acquired entity to which the goodwill relates.

26.22 If there is an indication that goodwill has been impaired the entity shall follow a two-step process to determine whether to recognise an impairment loss:

Step 1:

(a) allocate the goodwill to the **component(s) of the entity** that benefit from the goodwill (generally the lowest level within the entity at which the goodwill is monitored for internal management purposes);

(b) measure the fair value of each component in its entirety, including the goodwill;

(c) compare the fair value of the component with the carrying amount of the component;

(d) if the fair value of the component equals or exceeds its carrying amount, neither the component nor the goodwill is impaired; if the fair value of the component is less than its carrying amount, the difference is an impairment loss that shall be recognised in accordance with Step 2.

Step 2:

(a) write down the component's goodwill by the amount of the loss determined in Step 1(d) and recognise an impairment loss in profit or loss;

(b) if the amount of the loss determined in Step 1(d) exceeds the carrying amount of the component's goodwill, the excess shall be recognised as an impairment loss in profit or loss. That excess shall be allocated to the identifiable non-cash assets and liabilities, including contingent liabilities, of the component on the basis of their relative fair values.

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26.23 If there is a **minority interest** in the component to which goodwill has been allocated, the carrying amount of that component comprises:

(a) both the parent's interest and the minority interest in the identifiable net assets of the component; and

(b) the parent's interest in goodwill.

However, part of the fair value of the component determined in accordance with Step 1(b) is attributable to the minority interest in goodwill. Consequently, any impairment loss relating to the goodwill (Step 2(a)) is apportioned between that attributable to the parent and that attributable to the minority interest, with only the former being recognised as a goodwill impairment loss.

26.24 An impairment loss recognised for goodwill shall not be reversed in a subsequent period.

Disclosure

26.25 An entity shall disclose the following for each **class of assets**:

(a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) of the income statement in which those impairment losses are included.

(b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) of the income statement in which those impairment losses are reversed.

(c) the amount of impairment losses on revalued assets recognised directly in equity during the period.

(d) the amount of reversals of impairment losses on revalued assets recognised directly in equity during the period.

26.26 An entity shall disclose the following information for the aggregate impairment losses and the aggregate reversals of impairment losses recognised during the period for which no separate information is disclosed:

(a) the main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses.

(b) the main events and conditions that led to the recognition of these impairment losses and reversals of impairment losses.

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Section 27
Employee Benefits

27.1 **Employee benefits** are all forms of consideration given by an entity in exchange for service rendered by employees, including directors and management. This section applies to four types of employee benefits:

(a) short-term employee benefits, which are employee benefits (other than termination benefits) that are due wholly within twelve months after the end of the period in which the employees render the related service;

(b) **post-employment benefits**, which are employee benefits (other than **termination benefits**) that are payable after the completion of employment;

(c) other long-term employee benefits, which are employee benefits (other than post-employment benefits and termination benefits) that are not due wholly within twelve months after the end of the period in which the employees render the related service; and

(d) termination benefits, which are employee benefits payable as a result of either:

(i) an entity's decision to terminate an employee's employment before the normal retirement date; or

(ii) an employee's decision to accept voluntary redundancy in exchange for those benefits.

27.2 Employee benefits also include **share-based payments** either in the form of equity instruments (such as shares or share options) or cash or other assets of the entity in amounts that are based on the price of the entity's shares or other equity instruments of the entity, provided the specified vesting conditions, if any, are met. An entity shall apply Section 25 *Share-based Payment* in accounting for share-based payments.

General recognition principle for all employee benefits

27.3 An entity shall recognise the cost of all employee benefits to which its employees have become entitled as a result of service rendered to the entity during the period:

(a) as a liability, after deducting amounts that have been paid either directly to the employees or as a contribution to an employee

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benefit fund. If the contribution paid exceeds the obligation arising from service before the **reporting date**, an entity shall recognise that excess as an asset to the extent that the prepayment will lead to a reduction in future payments or a cash refund.

(b) as an expense, unless the cost:

(i) is included in the cost of producing inventories in accordance with Section 12 *Inventories*; or

(ii) is included in the cost of property, plant and equipment in accordance with Section 16 *Property, Plant and Equipment*.

Short-term employee benefits

Examples

27.4 Short-term employee benefits include items such as:

(a) wages, salaries and social security contributions;

(b) short-term compensated absences (such as paid annual leave and paid sick leave) when the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;

(c) profit-sharing and bonuses payable within twelve months after the end of the period in which the employees render the related service; and

(d) non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

Measurement of short-term benefits generally

27.5 When an employee has rendered service to an entity during the **reporting period**, the entity shall measure the amounts recognised in accordance with paragraph 27.3 at the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service.

Recognition and measurement—short-term compensated absences

27.6 Some short-term compensated absences accumulate. Examples include annual vacation leave and sick leave that can be carried forward and used

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in future periods if the employee does not use the current period's entitlement in full. An entity shall recognise the expected cost of **accumulating compensated absences** when the employees render service that increases their entitlement to future compensated absences. The entity shall measure the expected cost of accumulating compensated absences at the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the end of the reporting period. The entity shall present the unused accumulating compensated absences that are expected to be used as a **current liability** at the reporting date.

27.7 An entity shall recognise the cost of other (non-accumulating) compensated absences when the absences occur. The entity shall measure the cost of non-accumulating compensated absences at the undiscounted amount of salaries and wages paid or payable for the period of absence.

Recognition—profit-sharing and bonus plans

27.8 An entity shall recognise the expected cost of profit-sharing and bonus payments only when:

(a) the entity has a present legal or **constructive obligation** to make such payments as a result of past events (this means that the entity has no realistic alternative but to make the payments); and

(b) a reliable estimate of the obligation can be made.

Post-employment benefits: distinction between defined contribution plans and defined benefit plans

27.9 Post-employment benefits include, for example:

(a) retirement benefits, such as pensions, and

(b) other post-employment benefits, such as post-employment life insurance and post-employment medical care.

Arrangements whereby an entity provides post-employment benefits are post-employment benefit plans. An entity shall apply this section to all such arrangements whether or not they involve the establishment of a separate entity to receive contributions and to pay benefits. In some cases, these arrangements are imposed by law rather than by action of the entity.

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27.10 Post-employment benefit plans are classified as either **defined contribution plans** or **defined benefit plans**, depending on the economic substance of the plan as derived from its principal terms and conditions.

(a) Defined contribution plans are post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and has no legal or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. Thus, the amount of the post-employment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a post-employment benefit plan or to an insurer, together with investment returns arising from the contributions.

(b) Defined benefit plans are post-employment benefit plans other than defined contribution plans. Under defined benefit plans, the entity's obligation is to provide the agreed benefits to current and former employees, and actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity. If actuarial or investment experience is worse than expected, the entity's obligation may be increased.

Multi-employer plans and state plans

27.11 Multi-employer plans and state plans are classified as defined contribution plans or defined benefit plans on the basis of the terms of the plan, including any constructive obligation that goes beyond the formal terms. However, if sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall:

(a) account for the plan in accordance with paragraph 27.13 as if it were a defined contribution plan; and

(b) disclose the fact that it is a defined benefit plan and the reason why it is being accounted for as a defined contribution plan, along with any available information about the plan's surplus or deficit and the implications, if any, for the entity.

Insured benefits

27.12 An entity may pay insurance premiums to fund a post-employment benefit plan. The entity shall treat such a plan as a defined contribution

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plan unless the entity has a legal or constructive obligation either:

(a) to pay the employee benefits directly when they become due, or

(b) to pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.

A constructive obligation could arise indirectly through the plan, through the mechanism for setting future premiums, or through a **related party** relationship with the insurer. If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

Post-employment benefits: defined contribution plans

Recognition and measurement

27.13 The entity shall recognise the contribution payable for a period:

(a) as a liability, after deducting any amount already paid. If contribution payments exceed the contribution due for service before the reporting date, an entity shall recognise that excess as an asset.

(b) as an expense, unless the cost:

(i) is included in the cost of producing inventories in accordance with Section 12 *Inventories*; or

(ii) is included in the cost of property, plant and equipment in accordance with Section 16 *Property, Plant and Equipment*.

Post-employment benefits: defined benefit plans

Recognition

27.14 In applying the general recognition principle in paragraph 27.3 to defined benefit plans, an entity:

(a) recognises a liability for its obligations under defined benefit plans net of plan assets—its 'defined benefit liability' (see paragraphs 27.15–27.20); and

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(b) recognises the net change in that liability during the period as the cost of its defined benefit plans during the period (see paragraphs 27.21–27.25).

Measurement of the defined benefit liability

27.15 An entity shall measure a **defined benefit liability** for its obligations under defined benefit plans at the net total of the following amounts:

(a) the **present value** of its obligations under defined benefit plans (its **defined benefit obligation**) at the reporting date (paragraph 27.17 provides guidance on discounting), minus

(b) the fair value at the reporting date of **plan assets** (if any) out of which the obligations are to be settled directly. Paragraphs 11.14–11.17 establish requirements for determining the fair values of those plan assets that are **financial assets**.

27.16 The present value of an entity's obligations under defined benefit plans at the reporting date shall reflect the estimated amount of benefit that employees have earned in return for their service in the current and prior periods, including benefits that are not yet **vested** (see paragraph 27.23) and including the effects of benefit formulas that give employees greater benefits for later years of service. This requires the entity to determine how much benefit is attributable to the current and prior periods on the basis of the plan's benefit formula and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that influence the cost of the benefit. The actuarial assumptions shall be unbiased (neither imprudent nor excessively conservative), mutually compatible, and selected to lead to the best estimate of the future cash flows that will arise under the plan.

Discounting

27.17 An entity shall measure its defined benefit obligation on a discounted present value basis. The entity shall determine the rate used to discount the future payments by reference to market yields at the reporting date on high quality corporate bonds. In countries where there is no deep market in such bonds, the entity shall use the market yields (at the reporting date) on government bonds. The currency and term of the corporate bonds or government bonds shall be consistent with the currency and estimated period of the future payments.

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Actuarial valuation method

27.18 An entity shall use the **projected unit credit method** to determine its defined benefit obligations and the related current service cost and, when applicable, past service cost.

Plan introductions, changes, curtailments and settlements

27.19 If a defined benefit plan has been introduced or changed in the current period, the entity shall increase or decrease its defined benefit liability to reflect the change, and shall recognise the increase (decrease) as an expense (income) in measuring profit or loss. Conversely, if a plan has been curtailed (ie benefits or group of covered employees are reduced) or settled (the employer's obligation is completely discharged), the defined benefit obligation shall be decreased or eliminated, and the entity shall recognise the resulting gain or loss in profit or loss.

Defined benefit plan asset

27.20 If the defined benefit liability at the reporting date is less than the fair value of plan assets at that date, the plan has a surplus. An entity shall recognise a plan surplus as a defined benefit plan asset only to the extent that it is able to recover the surplus either through reduced contributions in the future or through refunds from the plan.

Cost of a defined benefit plan

27.21 An entity shall recognise the net change in its defined benefit liability during the period, other than a change attributable to benefits paid to employees during the period or due to contributions from the employer, as the cost of its defined benefit plans during the period. That cost is recognised in profit or loss, unless:

(a) it is included in the cost of producing inventories in accordance with Section 12; or

(b) it is included in the cost of property, plant and equipment in accordance with Section 16.

27.22 The net change in the defined benefit liability that is recognised as the cost of a defined benefit plan includes:

(a) the change in the defined benefit liability arising from employee service rendered during the reporting period;

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(b) interest on the defined benefit obligation during the reporting period;

(c) the returns on any plan assets and the net change in the fair value of recognised reimbursement rights (see paragraph 27.26) during the reporting period;

(d) actuarial gains and losses arising in the reporting period;

(e) increases or decreases in the defined benefit liability resulting from introducing a new plan or changing an existing plan in the reporting period (see paragraph 27.19); and

(f) decreases in the defined benefit liability resulting from curtailing or settling an existing plan in the reporting period (see paragraph 27.19).

27.23 Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words, they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive reporting date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy vesting requirements. Similarly, although some post-employment benefits, for example, post-employment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

27.24 If defined benefits are based on future salaries, an entity shall measure its defined benefit obligations on a basis that reflects estimated future salary increases.

27.25 If defined benefits are reduced for amounts that will be paid to employees under government-sponsored plans, an entity shall measure its defined benefit obligations on a basis that reflects the benefits payable under the government plans but only if:

(a) those plans were enacted before the reporting date; or

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(b) past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.

Reimbursements

27.26 If an entity is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, the entity shall recognise its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In the income statement, the expense relating to a defined benefit plan may be presented net of the amount recognised for a reimbursement.

Other long-term employee benefits

27.27 Other long-term employee benefits include, for example:

(a) long-term compensated absences such as long-service or sabbatical leave;

(b) jubilee or other long-service benefits;

(c) long-term disability benefits;

(d) profit-sharing and bonuses payable twelve months or more after the end of the period in which the employees render the related service; and

(e) deferred compensation paid twelve months or more after the end of the period in which it is earned.

27.28 An entity shall recognise a liability for other long-term employee benefits measured at the net total of the following amounts:

(a) the present value of the benefit obligation at the reporting date, minus

(b) the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.

An entity shall recognise the change in the liability in accordance with paragraph 27.21.

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Termination benefits

27.29 An entity may be committed, by legislation, by contractual or other agreements with employees or their representatives or by a constructive obligation based on business practice, custom or a desire to act equitably, to make payments (or provide other benefits) to employees when it terminates their employment. Such payments are termination benefits.

Recognition

27.30 Because termination benefits do not provide an entity with future economic benefits, an entity shall recognise them as an expense in profit or loss immediately.

27.31 When an entity recognises termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits.

27.32 An entity shall recognise termination benefits as a liability and an expense only when the entity is demonstrably committed either:

(a) to terminate the employment of an employee or group of employees before the normal retirement date; or

(b) to provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

27.33 An entity is demonstrably committed to a termination only when the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal from the plan.

Measurement

27.34 An entity shall measure termination benefits at the best estimate of the expenditure that would be required to settle the obligation at the reporting date. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.

27.35 When termination benefits are due more than twelve months after the end of the reporting period, they shall be measured at their discounted present value.

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Disclosure

Disclosures about short-term employee benefits

27.36 This section does not require specific disclosures about short-term employee benefits.

Disclosures about defined contribution plans

27.37 An entity shall disclose the total cost of defined contribution plans for the period and their amounts (a) recognised in profit or loss as an expense and (b) included in the cost of an asset.

Disclosures about defined benefit plans

27.38 An entity shall disclose the following information about defined benefit plans:

(a) a general description of the type of plan, including funding policy;

(b) the entity's accounting policy for recognising actuarial gains and losses and the amount of actuarial gains and losses recognised during the period;

(c) a reconciliation of opening and closing balances of the defined benefit liability showing separately benefits paid and all other changes;

(d) an analysis of the defined benefit liability into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded;

(e) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset, showing separately, if applicable:

(i) contributions by the employer;

(ii) contributions by plan participants;

(iii) benefits paid; and

(iv) other changes in plan assets.

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(f) the total cost relating to defined benefit plans recognised in profit or loss as an expense for the period, and the line item(s) in which they are included;

(g) the total cost relating to defined benefit plans during the period that was:

  (i) included in the cost of producing inventories in accordance with Section 12; or

  (ii) included in the cost of property, plant and equipment in accordance with Section 16;

(h) for each major category of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total plan assets;

(i) the amounts included in the fair value of plan assets for:

  (i) each category of the entity's own **financial instruments**; and

  (ii) any property occupied by, or other assets used by, the entity;

(j) the actual return on plan assets; and

(k) the principal actuarial assumptions used, including, when applicable:

  (i) the discount rates;

  (ii) the expected rates of return on any plan assets for the periods presented in the financial statements;

  (iii) the expected rates of salary increases; and

  (iv) medical cost trend rates.

Disclosures about other long-term benefits

27.39 For each category of other long-term benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the funding status at the reporting date, and the amount of any actuarial gains and losses arising in the current period and its **accounting policy** for such actuarial gains and losses.

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Disclosures about termination benefits

27.40 For each category of termination benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, its accounting policy, and the amount of its obligation and the funding status at the reporting date.

27.41 When there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. Section 20 *Provisions and Contingencies* requires an entity to disclose information about its contingent liability unless the possibility of an outflow in settlement is remote.

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Section 28
Income Taxes

28.1 For the purposes of this [draft] standard, **income taxes** include all domestic and foreign taxes that are based on **taxable profits**. Income taxes also include taxes, such as withholding taxes, that are payable by a **subsidiary**, **associate** or **joint venture** on distributions to the reporting entity.

28.2 This section requires an entity to recognise the current and future tax consequences of transactions and other events that have been recognised in the financial statements. Current tax liabilities and assets are recognised for **current tax** payable or current tax recoverable. **deferred tax liabilities** and **deferred tax assets** are recognised for the tax consequences of the future recovery or settlement of the entity's assets and liabilities at their current **carrying amounts**, with limited exceptions, and for unused tax losses and unused tax credits.

Tax basis

28.3 **Tax basis** is the measurement under applicable existing tax law of an asset, liability or equity instrument. That asset, liability, or equity instrument may be recognised for both tax and financial reporting purposes, for tax purposes but not for financial reporting, or for financial reporting purposes but not for tax. Stated another way, the tax basis of an asset or liability is the amount that would be recognised if a balance sheet were created using tax law as the basis for accounting.

28.4 The following examples illustrate the concept of tax basis:

(a) A machine cost 100. For tax purposes, depreciation of 30 has already been deducted in the current and prior periods and the remaining cost will be deductible in future periods, either as depreciation or through a deduction on disposal. Revenue generated by using the machine is taxable, any gain on disposal of the machine will be taxable and any loss on disposal will be deductible for tax purposes. The tax basis of the machine is 70.

(b) Interest receivable has a carrying amount of 100. The related interest revenue will be taxed on a cash basis. The tax basis of the interest receivable is nil.

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(c) Trade receivables have a carrying amount of 100. The related revenue has already been included in taxable profit (tax loss). The tax basis of the trade receivables is 100.

(d) A loan receivable has a carrying amount of 100. The repayment of the loan will have no tax consequences. The tax basis of the loan is 100.

Temporary differences

28.5 **Temporary differences** are differences between the tax basis of an asset or liability and its carrying amount in the financial statements that will result in a taxable or deductible amount when the carrying amount of the asset or liability is recovered or settled. Temporary differences may be either taxable or deductible:

(a) **Taxable temporary differences** are temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

(b) **Deductible temporary differences** are temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

Temporary differences that are timing differences

28.6 Some temporary differences arise when income or expense is included in accounting profit or loss in one period but is included in taxable profit in a different period. Such temporary differences are often described as **timing differences**.

Timing differences—examples

28.7 A timing difference results in a deferred tax asset when:

(a) an expenditure is deductible for tax purposes later than when it is recognised as an expense for financial reporting purposes. For example, in some jurisdictions:

(i) pension or other employee benefit cost is recognised as an expense over the periods of employee service, but is deductible for tax purposes only in future periods when contributions or payments are made.

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(ii) warranty expense is recognised when the related sales are made, but is deductible for tax purposes only when paid.

(iii) a tax loss cannot be offset against past or current period taxable profits, but can be carried forward to reduce future taxable profits.

(iv) bad debts expense is recognised when the accounts receivable are estimated to be uncollectible, but is tax-deductible only when a customer enters formal bankruptcy proceedings.

(b) income is taxable earlier than when it is recognised for financial reporting purposes. For example, in some jurisdictions:

(i) advance payments received from customers are taxed on a cash basis, but do not yet qualify for recognition as revenue.

(ii) intragroup profits in inventories, unrealised at the group level, are reversed on consolidation.

(iii) a gain is recognised for tax purposes on the sale of a **financial asset** carried at amortised cost, but the transaction does not qualify for recognition as a sale for financial reporting purposes.

28.8 A timing difference results in a deferred tax liability when:

(a) income is taxable later than when it is recognised for financial reporting purposes. For example, in some jurisdictions:

(i) an increase in the fair value of an asset is recognised in profit or loss, but that increase is taxable only when the asset is sold.

(ii) for accounting purposes revenue is recognised by reference to the stage of completion of a contract or transaction (sometimes referred to as the percentage of completion method), but for tax purposes revenue is taxable only when the contract or transaction is completed.

(iii) the unremitted earnings of subsidiaries, associates and joint ventures are recognised in profit or loss but will be subject to further taxation only when remitted to the parent.

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(b) an expense is deductible for tax purposes earlier than when it is recognised as an expense for financial reporting purposes. For example, in some jurisdictions:

  (i) an asset is depreciated more rapidly for tax purposes than for financial reporting purposes.

  (ii) borrowing costs or development costs are recognised in the cost of an asset but are tax-deductible when incurred.

Other temporary differences that are not timing differences

28.9 Some temporary differences are not timing differences. Such temporary differences can arise:

(a) when gains and losses are recognised outside accounting profit or loss in one period but are recognised in taxable profit in a different period.

(b) on the initial recognition of assets and liabilities, either in a **business combination** or outside a business combination.

(c) because of changes in the tax basis of an asset or liability that do not affect taxable profit of the period.

Goodwill

28.10 If the carrying amount of goodwill arising in a business combination differs from its tax basis, there is a temporary difference. A deferred tax asset arising from the initial recognition of goodwill is recognised as part of the accounting for a business combination. Paragraph 28.18(c) provides an exception to the recognition of a deferred tax liability arising from the initial recognition of goodwill.

Temporary differences in consolidated financial statements

28.11 In consolidated financial statements, there are two sources of temporary difference:

(a) differences between the carrying amounts of the individual assets and liabilities in the consolidated financial statements and their tax basis in the tax jurisdiction of the individual group entity. These temporary differences are sometimes described as 'inside basis differences'.

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(b) differences between the carrying amount of the investment of the parent or investor in its subsidiary, associate and joint venture and the tax basis of that investment in the tax jurisdiction of the investor. These temporary differences are often described as 'outside basis differences'.

28.12 In those jurisdictions in which a consolidated tax return is filed and taxes are assessed using consolidated amounts, the tax bases are determined by reference to the consolidated amounts. In those jurisdictions in which taxes are assessed on each individual entity in a group, the tax bases are determined by reference to each individual entity's tax computations.

Recognition of current tax liabilities and current tax assets

28.13 An entity shall recognise a liability for unpaid current tax for current and prior periods. If the amount already paid for current and prior periods exceeds the amount due for those periods, the entity shall recognise the excess as an asset.

28.14 An entity shall recognise an asset for the benefit relating to a tax loss that can be carried back to recover current tax of a previous period.

Recognition of deferred tax liabilities and deferred tax assets

Taxable temporary differences

28.15 An entity shall recognise a deferred tax liability for all taxable temporary differences, except as specified in paragraph 28.18.

Deductible temporary differences, unused tax losses and unused tax credits

28.16 Subject to paragraph 28.18(a), an entity shall recognise a deferred tax asset for:

(a) all deductible temporary differences, except as specified in paragraph 28.18(b).

(b) the carryforward of unused tax losses and unused tax credits.

(c) differences between:

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(i) amounts that an entity initially recognises as the cost or other carrying amount of an asset or liability, and

(ii) the amounts relating to that asset or liability that are expected to be deductible or includible in taxable income in future periods.

Such differences can arise in business combinations or on the initial acquisition of individual assets or liabilities. For example, a deferred tax asset or liability is recognised when the amount allocated to an asset acquired in a business combination is its fair value at the acquisition date, but the future tax-deductibility is limited by law to the acquired entity's original cost basis.

Initial recognition of assets and liabilities

28.17 An entity shall apply the principles in paragraphs 28.15 and 28.16 at the time an asset or liability is initially recognised, whether acquired in a business combination or otherwise. The carrying amount of the asset or liability at initial recognition affects the amount of the deferred tax liability or deferred tax asset that is recognised. Consequently, the carrying amount of that asset or liability at initial recognition will equal the fair value that the asset or liability would have had if its tax basis and fair value were equal. Outside a business combination, an entity shall recognise, as an adjustment to the deferred tax balance, any difference between (a) the sum of the carrying amount of the asset or liability and the resulting deferred tax balance and (b) the amount paid or received.

Exceptions to the general principles for recognising deferred taxes

28.18 The following are exceptions to the general principles for recognition of deferred taxes in paragraph 28.15–28.17:

(a) An entity shall recognise a deferred tax asset only to the extent that it is **probable** that there will be sufficient future taxable profit to enable recovery of the deferred tax asset.

(b) An entity shall not recognise deferred tax expense (income) or a related deferred tax liability (asset) for temporary differences associated with unremitted earnings from foreign subsidiaries, branches and associates and joint ventures, unless it is probable that the temporary difference will reverse in the foreseeable future.

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(c) An entity shall not recognise a deferred tax liability for temporary differences associated with the initial recognition of goodwill.

Recognition directly in equity

28.19 An entity shall recognise changes in a current or deferred tax liability or a current or deferred tax asset directly in equity, rather than in profit or loss, if the income or expense that gave rise to the temporary difference was recognised directly in equity.

Measurement

Measurement of current tax assets and liabilities

28.20 An entity shall measure current tax liabilities (assets) for the current and prior periods, and related **tax expense (income)**, at the amount expected to be paid to (recovered from) the taxation authorities, using the tax rates (and tax laws) that have been enacted or **substantively enacted** by the **reporting date**.

Measurement of deferred tax liabilities (assets)

28.21 An entity shall measure deferred tax assets and liabilities, and related tax expense (income), at the tax rates that are expected to apply to the period when the asset is realised or the liability is settled, based on tax rates (and tax laws) that have been enacted or substantively enacted by the reporting date.

Discounting

28.22 Although deferred tax assets and deferred tax liabilities give rise to future cash flows, an entity shall not discount them to reflect the time value of money.

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Which tax rate to use

28.23 When different tax rates apply to different levels of taxable income, an entity shall measure deferred tax expense (income) and related deferred tax liabilities (assets) using the average enacted or substantively enacted rates that it expects to be applicable to the taxable profit (tax loss) of the periods in which it expects the temporary differences to reverse.

28.24 The measurement of deferred tax expense (income) and related deferred tax liabilities (assets) shall reflect the tax consequences that would follow from the manner in which the entity expects at the reporting date to recover or settle the carrying amounts of its assets and liabilities. For example, if the temporary difference arises from an item of income that is expected to be taxable as a capital gain in a future period, the deferred tax expense is measured using the capital gain tax rate.

28.25 In some jurisdictions, income taxes are payable at a higher or lower rate if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In other jurisdictions, income taxes may be refundable or payable if part or all of the profit or retained earnings is paid out as a dividend to shareholders of the entity. In those circumstances, an entity shall measure current and deferred taxes at the tax rate applicable to undistributed profits until the entity recognises a liability to pay a dividend. When the entity recognises a liability to pay a dividend, it shall recognise the resulting current or deferred tax liability (asset), and the related tax expense (income).

Review of deferred tax assets

28.26 An entity shall review the carrying amount of a deferred tax asset at each reporting date. An entity shall reduce the carrying amount of a deferred tax asset and increase tax expense to the extent that it is impaired, ie it is no longer probable that sufficient taxable profit will be available to allow recovery of the deferred tax asset. The entity shall reverse that reduction to the extent that it subsequently becomes probable that sufficient taxable profit will be available.

Withholding tax on dividends

28.27 When an entity pays dividends to its shareholders, it may be required to pay a portion of the dividends to taxation authorities on behalf of shareholders. Such an amount paid or payable to taxation authorities is recognised in equity as a part of the dividends.

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Disclosure

28.28 An entity shall disclose separately the major components of tax expense (income). Such components of tax expense (income) may include:

(a) current tax expense (income);

(b) any adjustments recognised in the period for current tax of prior periods;

(c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences;

(d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes;

(e) the amount of the benefit arising from a previously unrecognised tax losses, tax credits or temporary differences of a prior period that is used to reduce current tax expense; and

(f) deferred tax expense (or income) arising from the impairment, or reversal of a previous impairment, of a deferred tax asset (see paragraph 28.26).

28.29 An entity shall disclose the following separately:

(a) the aggregate current and deferred tax relating to items that are recognised directly in equity;

(b) a numerical reconciliation between tax expense (income) as recognised and tax expense (income) that would be expected by multiplying profit by the applicable tax rate(s), with each significant difference disclosed separately;

(c) an explanation of changes in the applicable tax rate(s) compared with the previous **reporting period**;

(d) the amount (and expiry date, if any) of temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised; and

(e) the aggregate amount of temporary differences associated with investments in foreign subsidiaries, branches and associates and joint ventures, for which deferred tax liabilities have not been recognised (see paragraph 28.18(b)).

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(f) the aggregate amount of temporary differences associated with the initial recognition of goodwill for which deferred tax liabilities have not been recognised (see paragraph 28.18(c)).

28.30 In the circumstances described in paragraph 28.25, an entity shall disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the entity shall disclose the amounts of the potential income tax consequences, if practicably determinable, and whether there are any potential income tax consequences not practicably determinable.

Section 29
Financial Reporting in Hyperinflationary Economies

29.1 **Hyperinflation** is indicated by characteristics of the economic environment of a country. An economy is hyperinflationary if the cumulative inflation rate over three years is approaching, or exceeds, 100 per cent.

29.2 An entity whose functional currency is the currency of a hyperinflationary economy shall apply IAS 29 *Financial Reporting in Hyperinflationary Economies* in preparing and presenting its financial statements in accordance with this [draft] standard.

29.3 Briefly summarised, IAS 29 requires that the financial statements of an entity whose functional currency is the currency of a hyperinflationary economy should be stated in terms of the presentation currency as of the end of the **reporting period**. The corresponding figures for the previous period required by paragraph 3.12 and any information in respect of earlier periods shall also be stated in terms of the measuring unit current at the end of the reporting period. The gain or loss on the net monetary position shall be included in profit or loss and separately disclosed.

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Section 30
Foreign Currency Translation

30.1 An entity may conduct foreign activities in two ways. It may have transactions in foreign currencies or it may have foreign operations. In addition, an entity may present its financial statements in a foreign currency. This section prescribes how to include foreign currency transactions and foreign operations in the financial statements of an entity and how to translate financial statements into a **presentation currency**. Accounting for **financial instruments** denominated in a foreign currency and hedge accounting of foreign currency items is dealt with in Section 11 *Financial Instruments*.

Functional currency

30.2 Each entity shall identify its **functional currency**. Functional currency is the currency of the primary economic environment in which the entity operates.

30.3 The primary economic environment in which an entity operates is normally the one in which it primarily generates and expends cash. Therefore, the following are the most important factors an entity considers in determining its functional currency:

(a) the currency:

(i) that mainly influences sales prices for goods and services (this will often be the currency in which sales prices for its goods and services are denominated and settled); and

(ii) of the country whose competitive forces and regulations mainly determine the sales prices of its goods and services.

(b) the currency that mainly influences labour, material and other costs of providing goods or services (this will often be the currency in which such costs are denominated and settled).

30.4 The following factors may also provide evidence of an entity's functional currency:

(a) the currency in which funds from financing activities (ie issuing debt and equity instruments) are generated.

(b) the currency in which receipts from operating activities are usually retained.

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30.5 The following additional factors are considered in determining the functional currency of a foreign operation, and whether its functional currency is the same as that of the reporting entity (the reporting entity, in this context, being the entity that has the foreign operation as its subsidiary, branch, associate or joint venture):

(a) whether the activities of the foreign operation are carried out as an extension of the reporting entity, rather than being carried out with a significant degree of autonomy. An example of the former is when the foreign operation only sells goods imported from the reporting entity and remits the proceeds to it. An example of the latter is when the operation accumulates cash and other monetary items, incurs expenses, generates income and arranges borrowings, all substantially in its local currency.

(b) whether transactions with the reporting entity are a high or a low proportion of the foreign operation's activities.

(c) whether cash flows from the activities of the foreign operation directly affect the cash flows of the reporting entity and are readily available for remittance to it.

(d) whether cash flows from the activities of the foreign operation are sufficient to service existing and normally expected debt obligations without funds being made available by the reporting entity.

Reporting foreign currency transactions in the functional currency

Initial recognition

30.6 A foreign currency transaction is a transaction that is denominated or requires settlement in a foreign currency, including transactions arising when an entity:

(a) buys or sells goods or services whose price is denominated in a foreign currency;

(b) borrows or lends funds when the amounts payable or receivable are denominated in a foreign currency; or

(c) otherwise acquires or disposes of assets, or incurs or settles liabilities, denominated in a foreign currency.

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30.7 An entity shall record a foreign currency transaction, on initial recognition in the functional currency, by applying to the foreign currency amount the spot exchange rate between the functional currency and the foreign currency at the date of the transaction.

30.8 The date of a transaction is the date on which the transaction first qualifies for recognition in accordance with this [draft] standard. For practical reasons, a rate that approximates the actual rate at the date of the transaction is often used, for example, an average rate for a week or a month might be used for all transactions in each foreign currency occurring during that period. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

Reporting at the end of the subsequent reporting periods

30.9 At the end of each **reporting period**, an entity shall:

(a) translate foreign currency monetary items using the closing rate;

(b) translate non-monetary items that are measured in terms of historical cost in a foreign currency using the exchange rate at the date of the transaction; and

(c) translate non-monetary items that are measured at fair value in a foreign currency using the exchange rates at the date when the fair value was determined.

30.10 An entity shall recognise, in profit or loss in the period in which they arise, exchange differences arising on the settlement of monetary items or on translating monetary items at rates different from those at which they were translated on initial recognition during the period or in previous financial statements, except as described in paragraph 30.13.

30.11 When a gain or loss on a non-monetary item is recognised directly in equity, an entity shall recognise any exchange component of that gain or loss directly in equity. Conversely, when a gain or loss on a non-monetary item is recognised in profit or loss, an entity shall recognise any exchange component of that gain or loss in profit or loss.

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Net investment in a foreign operation

30.12 An entity may have a monetary item that is receivable from or payable to a foreign operation. An item for which settlement is neither planned nor likely to occur in the foreseeable future is, in substance, a part of the entity's net investment in that foreign operation, and is accounted for in accordance with paragraph 30.13. Such monetary items may include long-term receivables or loans. They do not include trade receivables or trade payables.

30.13 Exchange differences arising on a monetary item that forms part of a reporting entity's net investment in a foreign operation shall be recognised in profit or loss in the separate financial statements of the reporting entity or the individual financial statements of the foreign operation, as appropriate. In the financial statements that include the foreign operation and the reporting entity (eg consolidated financial statements when the foreign operation is a subsidiary), such exchange differences shall be recognised initially in a separate component of equity and recognised in profit or loss on disposal of the net investment in accordance with paragraph 30.24.

Change in functional currency

30.14 When there is a change in an entity's functional currency, the entity shall apply the translation procedures applicable to the new functional currency prospectively from the date of the change.

30.15 As noted in paragraph 30.2, the functional currency of an entity reflects the underlying transactions, events and conditions that are relevant to the entity. Accordingly, once the functional currency is determined, it can be changed only if there is a change to those underlying transactions, events and conditions. For example, a change in the currency that mainly influences the sales prices of goods and services may lead to a change in an entity's functional currency.

30.16 The effect of a change in functional currency is accounted for prospectively. In other words, an entity translates all items into the new functional currency using the exchange rate at the date of the change. The resulting translated amounts for non-monetary items are treated as their historical cost. Exchange differences arising from the translation of a foreign operation previously classified in equity in accordance with paragraph 30.13 are not recognised in profit or loss until the disposal of the operation.

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Use of a presentation currency other than the functional currency

Translation to the presentation currency

30.17 An entity may present its financial statements in any currency (or currencies). If the presentation currency differs from the entity's functional currency, the entity shall translate its results and **financial position** into the presentation currency. For example, when a group contains individual entities with different functional currencies, the results and financial position of each entity are expressed in a common currency so that consolidated financial statements may be presented.

30.18 An entity whose functional currency is not the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the following procedures:

(a) assets and liabilities for each balance sheet presented (ie including comparatives) shall be translated at the closing rate at the date of that balance sheet;

(b) income and expenses for each income statement (ie including comparatives) shall be translated at exchange rates at the dates of the transactions; and

(c) all resulting exchange differences shall be recognised as a separate component of equity.

30.19 For practical reasons, an entity may use a rate that approximates the exchange rates at the dates of the transactions, for example an average rate for the period, to translate income and expense items. However, if exchange rates fluctuate significantly, the use of the average rate for a period is inappropriate.

30.20 The exchange differences referred to in paragraph 30.18(c) result from:

(a) translating income and expenses at the exchange rates at the dates of the transactions and assets and liabilities at the closing rate. Such exchange differences arise both on income and expense items recognised in profit or loss and on those recognised directly in equity.

(b) translating the opening net assets at a closing rate that differs from the previous closing rate.

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When the exchange differences relate to a foreign operation that is consolidated but not wholly-owned, accumulated exchange differences arising from translation and attributable to **minority interests** are allocated to, and recognised as part of, minority interest in the consolidated balance sheet.

30.21 An entity whose functional currency is the currency of a hyperinflationary economy shall translate its results and financial position into a different presentation currency using the procedures specified in IAS 21 paragraphs 42 and 43.

Translation of a foreign operation into the investor's presentation currency

30.22 In incorporating the results and financial position of a foreign operation with those of the reporting entity, the entity shall follow normal consolidation procedures, such as the elimination of intragroup balances and intragroup transactions of a subsidiary (see Section 9 *Consolidated and Separate Financial Statements* and Section 14 *Investments in Joint Ventures*). However, an intragroup monetary asset (or liability), whether short-term or long-term, cannot be eliminated against the corresponding intragroup liability (or asset) without showing the results of currency fluctuations in the consolidated financial statements. This is because the monetary item represents a commitment to convert one currency into another and exposes the reporting entity to a gain or loss through currency fluctuations. Accordingly, in the consolidated financial statements of the reporting entity, an entity continues to recognise such an exchange difference in profit or loss or, if it arises from the circumstances described in paragraph 30.13, the entity shall classify it as equity until the disposal of the foreign operation.

30.23 Any goodwill arising on the acquisition of a foreign operation and any fair value adjustments to the **carrying amounts** of assets and liabilities arising on the acquisition of that foreign operation shall be treated as assets and liabilities of the foreign operation. Thus, they shall be expressed in the functional currency of the foreign operation and shall be translated at the closing rate in accordance with paragraph 30.18.

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Disposal of a foreign operation

30.24 On the disposal of a foreign operation, the cumulative amount of the exchange differences deferred in the separate component of equity relating to that foreign operation shall be recognised in profit or loss when the gain or loss on disposal is recognised.

Disclosure

30.25 In paragraphs 30.27 and 30.29, references to 'functional currency' apply, in the case of a group, to the functional currency of the parent.

30.26 An entity shall disclose:

(a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with Section 11; and

(b) net exchange differences classified in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.

30.27 An entity shall disclose the currency in which the financial statements are presented. When the presentation currency is different from the functional currency, an entity shall state that fact and shall disclose the functional currency and the reason for using a different presentation currency.

30.28 When there is a change in the functional currency of either the reporting entity or a significant foreign operation, the entity shall disclose that fact and the reason for the change in functional currency.

30.29 When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency (for example, a 'convenience translation' of all amounts at closing rate), it shall:

(a) clearly identify the information as supplementary information to distinguish it from the information that complies with this [draft] standard;

(b) disclose the currency in which the supplementary information is displayed; and

(c) disclose the entity's functional currency and the method of translation used to determine the supplementary information.

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Section 31
Segment Reporting

31.1 An entity using this [draft] standard is not required to present information about **operating segments**. An entity that chooses to disclose segment information in financial statements described as conforming to the *IFRS for SMEs* shall comply fully with the requirements of IFRS 8 *Operating Segments*. If an entity discloses information about segments that does not comply with IFRS 8, it shall not describe the information as segment information.

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Section 32
Events after the End of the Reporting Period

32.1 Events after the end of the **reporting period** are those events, favourable and unfavourable, that occur between the end of the reporting period and the date when the financial statements are authorised for issue. There are two types of events:

(a) those that provide evidence of conditions that existed at the end of the reporting period (adjusting events after the end of the reporting period); and

(b) those that are indicative of conditions that arose after the end of the reporting period (non-adjusting events after the end of the reporting period).

32.2 Events after the end of the reporting period include all events up to the date when the financial statements are authorised for issue, even if those events occur after the public announcement of profit or of other selected financial information.

Recognition and measurement

Adjusting events after the end of the reporting period

32.3 An entity shall adjust the amounts recognised in its financial statements, including related disclosures, to reflect adjusting events after the end of the reporting period.

32.4 The following are examples of adjusting events after the end of the reporting period that require an entity to adjust the amounts recognised in its financial statements, or to recognise items that were not previously recognised:

(a) the settlement after the end of the reporting period of a court case that confirms that the entity had a present obligation at the end of the reporting period. The entity adjusts any previously recognised **provision** related to this court case in accordance with Section 20 *Provisions and Contingencies* or recognises a new provision. The entity does not merely disclose a contingent liability because the settlement provides additional evidence that would be considered in accordance with Section 20.

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(b) the receipt of information after the end of the reporting period indicating that an asset was impaired at the end of the reporting period, or that the amount of a previously recognised impairment loss for that asset needs to be adjusted.

For example:

(i) the bankruptcy of a customer that occurs after the end of the reporting period usually confirms that a loss existed at the end of the reporting period on a trade receivable and that the entity needs to adjust the **carrying amount** of the trade receivable; and

(ii) the sale of inventories after the end of the reporting period may give evidence about their selling price at the end of the reporting period.

(c) the determination after the end of the reporting period of the cost of assets purchased, or the proceeds from assets sold, before the end of the reporting period.

(d) the determination after the end of the reporting period of the amount of profit-sharing or bonus payments, if the entity had a legal or **constructive obligation** at the end of the reporting period to make such payments as a result of events before that date (see Section 27 *Employee Benefits*).

(e) the discovery of fraud or **errors** that show that the financial statements are incorrect.

Non-adjusting events after the end of the reporting period

32.5 An entity shall not adjust the amounts recognised in its financial statements to reflect non-adjusting events after the end of the reporting period.

32.6 An example of a non-adjusting event after the end of the reporting period is a decline in market value of investments between the end of the reporting period and the date when the financial statements are authorised for issue. The decline in market value does not normally relate to the condition of the investments at the end of the reporting period, but reflects circumstances that have arisen subsequently. Therefore, an entity does not adjust the amounts recognised in its

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financial statements for the investments. Similarly, the entity does not update the amounts disclosed for the investments as at the end of the reporting period, although it may need to give additional disclosure in accordance with paragraph 32.9.

Dividends

32.7 If an entity declares dividends to holders of equity instruments after the end of the reporting period, the entity shall not recognise those dividends as a liability at the end of the reporting period.

Disclosure

Date of authorisation for issue

32.8 An entity shall disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the entity's owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact.

Non-adjusting events after the end of the reporting period

32.9 An entity shall disclose the following for each category of non-adjusting event after the end of the reporting period:

(a) the nature of the event; and

(b) an estimate of its financial effect, or a statement that such an estimate cannot be made.

32.10 The following are examples of non-adjusting events after the end of the reporting period that would generally result in disclosure:

(a) a major business combination (Section 18 *Business Combinations* requires specific disclosures in such cases) or disposing of a major subsidiary.

(b) announcing a plan to discontinue an operation.

(c) major purchases of assets, classification of assets as held for sale in accordance with Section 16 *Property, Plant and Equipment*, other disposals of assets, or expropriation of major assets by government.

(d) the destruction of a major production plant by a fire.

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(e) announcing, or commencing the implementation of, a major restructuring (see Section 20).

(f) major ordinary share transactions and potential ordinary share transactions.

(g) abnormally large changes in asset prices or foreign exchange rates.

(h) changes in tax rates or tax laws enacted or announced that have a significant effect on current and deferred tax assets and liabilities (see Section 28 *Income Taxes*).

(i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees.

(j) commencing major litigation arising solely out of events that occurred after the end of the reporting period.

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Section 33
Related Party Disclosures

33.1 This section requires an entity to include in its **financial statements** the disclosures necessary to draw attention to the possibility that its **financial position** and profit or loss have been affected by the existence of **related parties** and by transactions and outstanding balances with such parties.

33.2 In considering each possible related party relationship, an entity shall assess the substance of the relationship and not merely the legal form.

33.3 In the context of this [draft] standard, the following are not necessarily related parties:

(a) two entities simply because they have a director or other member of key management personnel in common, notwithstanding (d) and (f) in the definition of 'related party'.

(b) two venturers simply because they share **joint control** over a **joint venture**.

(c) Any of the following simply by virtue of their normal dealings with an entity (even though they may affect the freedom of action of an entity or participate in its decision making process):

(i) providers of finance,

(ii) trade unions,

(iii) public utilities, and

(iv) government departments and agencies,

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

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Disclosure

Disclosure of relationships

33.4 Relationships between parents and subsidiaries shall be disclosed irrespective of whether there have been transactions between those related parties. An entity shall disclose the name of the entity's parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so (if any) shall also be disclosed.

Disclosure of key management personnel compensation

33.5 Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Compensation includes all employee benefits (as defined in Section 27 *Employee Benefits*) including those in the form of share-based payment (see Section 25 *Share-based Payment*). Employee benefits include all forms of consideration paid, payable or provided by the entity, or on behalf of the entity (for example, by its parent or by a shareholder), in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity.

33.6 An entity shall disclose key management personnel compensation in total and for each of the following categories:

(a) short-term employee benefits;

(b) post-employment benefits;

(c) other long-term benefits;

(d) termination benefits; and

(e) share-based payment.

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Disclosure of related party transactions

33.7 A **related party transaction** is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged. Examples of related party transactions that are common to SMEs include, but are not limited to:

(a) transactions between an entity and its principal owner(s).

(b) transactions between an entity and another entity where both entities are under the common control of a single entity or individual.

(c) transactions in which an entity or individual that controls the reporting entity incurs expenses directly that otherwise would have been borne by the reporting entity.

33.8 If there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to the requirements in paragraph 33.6 to disclose key management personnel compensation. At a minimum, disclosures shall include:

(a) the amount of the transactions;

(b) the amount of outstanding balances and:

(i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and

(ii) details of any guarantees given or received;

(c) provisions for uncollectible receivables related to the amount of outstanding balances; and

(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.

33.9 An entity shall make the disclosures required by paragraph 33.8 separately for each of the following categories:

(a) the parent;

(b) entities with joint control or significant influence over the entity;

(c) subsidiaries;

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(d) associates;

(e) joint ventures in which the entity is a venturer;

(f) key management personnel of the entity or its parent (in the aggregate); and

(g) other related parties.

33.10 The following are examples of transactions that are disclosed if they are with a related party:

(a) purchases or sales of goods (finished or unfinished);

(b) purchases or sales of property and other assets;

(c) rendering or receiving of services;

(d) leases;

(e) transfers of research and development;

(f) transfers under licence agreements;

(g) transfers under finance arrangements (including loans and equity contributions in cash or in kind);

(h) provision of guarantees or collateral;

(i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party; and

(j) participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities.

33.11 An entity shall not state that related party transactions were made on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated.

33.12 An entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

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Section 34
Earnings per Share

34.1 An entity using this [draft] standard is not required to present amounts of earnings per share. However, if the entity discloses earnings per share, it shall calculate and disclose earnings per share in accordance with IAS 33 *Earnings per Share*.

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Section 35
Specialised Industries

Agriculture

35.1 An entity using this [draft] standard that is engaged in **agricultural activity** shall determine, for each of its **biological assets**, whether the **fair value** of that biological asset is readily determinable without undue cost or effort:

(a) The entity shall apply the fair value model in paragraphs 10–29 of IAS 41 *Agriculture* to account for those biological assets whose fair value is readily determinable without undue cost or effort, and the entity shall make all related disclosures required by IAS 41.

(b) The entity shall measure at cost less any accumulated **depreciation** and any accumulated **impairment** losses those biological assets whose fair value is not readily determinable without undue cost or effort. The entity shall disclose, for such biological asset(s):

(i) a description of the biological assets;

(ii) an explanation of why fair value cannot be measured reliably;

(iii) if possible, the range of estimates within which fair value is highly likely to lie;

(iv) the depreciation method used;

(v) the useful lives or the depreciation rates used; and

(vi) the gross **carrying amount** and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

The entity shall measure **agricultural produce** harvested from its biological assets at fair value less estimated costs to sell at the point of harvest. Such measurement is the cost at that date when applying Section 12 *Inventories* or other sections of this [draft] standard.

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Extractive industries

35.2 An entity using this [draft] standard that is engaged in the exploration for, evaluation or extraction of mineral resources shall recognise exploration expenditure as an expense in the period in which it is incurred. In accounting for expenditure on the acquisition or development of tangible or intangible assets for use in extractive activities, the entity should apply Section 16 *Property, Plant and Equipment* and Section 17 *Intangible Assets other than Goodwill*, respectively. When an entity has an obligation to dismantle or remove an item, or to restore the site, such obligations and costs are accounted for in accordance with Section 16 and Section 20 *Provisions and Contingencies*.

Insurance

35.3 Because an insurer holds assets in a fiduciary capacity for a broad group of outsiders, it has public accountability and, therefore, is not included within SMEs as defined in paragraph 1.1. This [draft] standard is not intended for, and should not be used by, insurers.

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Section 36
Discontinued Operations and Assets Held for Sale

Discontinued operations

36.1 A **discontinued operation** is a **component of an entity** that either has been disposed of, or is classified as **held for sale**, and

(a) represents a separate major line of business or geographical area of operations;

(b) is part of a single co-ordinated plan to dispose of a separate major line of business or geographical area of operations; or

(c) is a subsidiary acquired exclusively with a view to resale.

Presentation and disclosure

36.2 An entity shall disclose:

(a) a single amount on the face of the income statement comprising the total of:

(i) the post-tax profit or loss of discontinued operations; and

(ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or group(s) of assets and liabilities constituting the discontinued operation.

(b) an analysis of the single amount in (a) into:

(i) the revenue, expenses, pre-tax profit or loss and income tax expense of discontinued operations;

(ii) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or group(s) of assets constituting the discontinued operation and the related income tax expense.

The analysis may be presented in the notes or on the face of the income statement. If it is presented on the face of the income statement it shall be presented in a section identified as relating to discontinued operations, ie separately from continuing operations.

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(c) the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or on the face of the **financial statements**.

36.3 Unless **impracticable**, an entity shall restate the disclosures in the preceding paragraph for prior periods presented in the financial statements so that the disclosures relate to all operations that have been discontinued by the end of the **reporting period** for the latest period presented.

36.4 If an entity ceases to classify a component of an entity as held for sale, the entity shall reclassify the results of operations of the component previously presented in discontinued operations and shall include them in income from continuing operations for all periods presented. The amounts for prior periods shall be described as having been restated.

Non-current assets held for sale

36.5 An entity shall classify non-current assets (including property, plant and equipment, intangibles, and investments in subsidiaries, associates and joint ventures) as held for sale if its **carrying amount** will be recovered principally through a sale transaction rather than through continuing use. For this to be the case, the asset (or **disposal group**) must be available for immediate sale in its present condition subject only to terms that are usual and customary for sales of such assets, its sale must be highly **probable**, and the entity must expect to complete the sale within one year from the date of classification as held for sale.

36.6 An entity shall measure a non-current asset (or disposal group) classified as held for sale at the lower of its carrying amount and fair value less costs to sell.

36.7 An entity shall not depreciate (or amortise) a non-current asset while it is classified as held for sale or while it is part of a disposal group classified as held for sale. Interest and other expenses attributable to the liabilities of a disposal group classified as held for sale shall continue to be recognised.

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Disclosure

36.8 An entity shall disclose the following information in the period in which non-current assets have been either classified as held for sale or sold:

(a) a description of the asset or disposal group;

(b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal; and

(c) the gain or loss recognised, if not separately presented on the face of the income statement.

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Section 37
Interim Financial Reporting

37.1 An entity that issues an **interim financial report** that is described as complying with this [draft] standard shall apply either IAS 34 *Interim Financial Reporting* or all of the requirements of this [draft] standard, except as provided in paragraph 37.2.

37.2 If an entity does not routinely prepare interim financial statements, but is required to do so on a one-time basis (for instance, in connection with a **business combination**), the entity may use its prior annual financial statements as its comparative prior period information required by IAS 34 or by paragraph 3.12, if it is **impracticable** to prepare financial statements for the comparable prior interim period.

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Section 38
Transition to the IFRS for SMEs

38.1 This section applies to a **first-time adopter of the** ***IFRS for SMEs***, regardless of whether its previous accounting framework was full **International Financial Reporting Standards (IFRSs)** or another set of generally accepted accounting principles (GAAP). A first-time adopter of the *IFRS for SMEs* shall apply this section in its first **financial statements** that conform to this [draft] standard.

38.2 An entity's first financial statements that conform to this [draft] standard are the first annual financial statements in which the entity makes an explicit and unreserved statement in those financial statements of compliance with the *IFRS for SMEs*. Financial statements prepared in accordance with this [draft] standard are an entity's first such financial statements if, for example, the entity:

(a) did not present financial statements for previous periods;

(b) presented its most recent previous financial statements under national requirements that are not consistent with this [draft] standard in all respects; or

(c) presented its most recent previous financial statements in conformity with International Financial Reporting Standards (full IFRSs).

38.3 Paragraph 3.15 of this [draft] standard defines a complete set of financial statements.

38.4 Paragraph 3.12 of this [draft] standard requires a complete set of financial statements to disclose comparative information in respect of the previous comparable period for all monetary amounts reported in the financial statements, as well as specified comparative narrative and descriptive information. An entity may present comparative information in respect of more than one comparable prior period. Therefore, the date of an entity's transition to this [draft] standard is the beginning of the earliest period for which the entity presents full comparative information in accordance with this [draft] standard in its first financial statements that conform to this [draft] standard.

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38.5 Except as provided in paragraphs 38.7–38.9, an entity shall, in its opening balance sheet as of its date of transition to this [draft] standard (ie beginning of the earliest period presented):

(a) recognise all assets and liabilities whose recognition is required by the *IFRS for SMEs*;

(b) not recognise items as assets or liabilities if this [draft] standard does not permit such recognition;

(c) reclassify items that it recognised under its previous financial reporting framework as one type of asset, liability or component of equity, but are a different type of asset, liability or component of equity under this [draft] standard; and

(d) apply this [draft] standard in measuring all recognised assets and liabilities.

38.6 The **accounting policies** that an entity uses in its opening balance sheet under this [draft] standard may differ from those that it used for the same date using its previous financial reporting framework. The resulting adjustments arise from transactions, other events or conditions before the date of transition to this [draft] standard. Therefore, an entity shall recognise those adjustments directly in retained earnings (or, if appropriate, another category of equity) at the date of transition to this [draft] standard.

38.7 On first-time adoption of this [draft] standard, an entity shall not change the accounting that it followed under its previous financial reporting framework for any of the following transactions:

(a) **derecognition** of financial assets and financial liabilities;

(b) hedge accounting;

(c) estimates; and

(d) assets classified as **held for sale** and **discontinued operations**.

38.8 An entity may use one or more of the following exemptions in preparing its first financial statements that conform to this [draft] standard:

(a) ***Business combinations.*** A first-time adopter may elect not to apply Section 18 *Business Combinations and Goodwill* to business combinations that were effected before the date of transition to this [draft] standard. However, if a first-time adopter restates any business combination to comply with Section 18, it shall restate all later business combinations.

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(b) ***Fair value or revaluation as deemed cost.*** A first-time adopter may use a previous GAAP revaluation of an item of property, plant and equipment at, or before, the date of transition to this [draft] standard as its deemed cost as of that date.

(c) ***Cumulative translation differences.*** Section 30 *Foreign Currency Translation* requires an entity to classify some translation differences as a separate component of equity and to recognise those differences in profit or loss on disposal. A first-time adopter may elect not to recognise any cumulative translation differences in equity on the date of transition to this [draft] standard.

(d) ***Compound financial instruments.*** Paragraph 21.7 requires an entity to split a compound financial instrument into its liability and equity components upon issue. A first-time adopter need not separate those two components if the liability component is not outstanding at the date of transition to this [draft] standard.

(e) ***Share-based payment transactions.*** A first-time adopter is encouraged, but not required, to apply Section 25 *Share-based Payment* to equity instruments that were granted before the date of transition to this [draft] standard.

(f) ***Deferred income taxes.*** A first-time adopter is not required to recognise **deferred tax assets or deferred tax liabilities** relating to differences between the **tax basis** and the **carrying amount** of any assets or liabilities for which recognition of those deferred tax assets or liabilities would involve undue cost or effort.

38.9 If it is **impracticable** for an entity to restate the opening balance sheet at the date of transition in accordance with this [draft] standard, the entity shall apply paragraphs 38.5–38.8 in the earliest period for which it is practicable to do so, and shall disclose the date of transition and the fact that data presented for prior periods are not comparable. If it is impracticable for an entity to provide any disclosures required by this [draft] standard for any period before the period in which it prepares its first financial statements that conform to this [draft] standard, the omission shall be disclosed.

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Disclosures

Explanation of transition to the *IFRS for SMEs*

38.10 An entity shall explain how the transition from its previous financial reporting framework to this [draft] standard affected its reported **financial position**, financial **performance** and **cash flows**.

Reconciliations

38.11 To comply with paragraph 38.10, an entity's first financial statements prepared using this [draft] standard shall include:

(a) reconciliations of its equity reported under its previous financial reporting framework to its equity under this [draft] standard for both of the following dates:

(i) the date of transition to this [draft] standard; and

(ii) the end of the latest period presented in the entity's most recent annual financial statements under its previous financial reporting framework; and

(b) a reconciliation of the profit or loss reported under its previous financial reporting framework for the latest period in the entity's most recent annual financial statements to its profit or loss under this [draft] standard for the same period.

38.12 If an entity becomes aware of errors made under its previous financial reporting framework, the reconciliations required by paragraph 38.11(a) and (b) shall distinguish the correction of those errors from changes in accounting policies.

38.13 If an entity did not present financial statements for previous periods, it shall disclose that fact in its first financial statements that conform to this [draft] standard.

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GLOSSARY

accounting policies	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.
accrual basis of accounting	The effects of transactions and other events are recognised when they occur (and not as cash or its equivalent is received or paid) and they are recorded in the accounting records and reported in the financial statements of the periods to which they relate.
accumulating compensated absences	Compensated absences that are carried forward and can be used in future periods if the current period's entitlement is not used in full.
agricultural activity	The management by an entity of the biological transformation of biological assets for sale, into agricultural produce or into additional biological assets.
agricultural produce	The harvested product of the entity's biological assets.
amortisation	The systematic allocation of the depreciable amount of an asset over its useful life.
asset	A resource controlled by the entity as a result of past events and from which future economic benefits are expected to flow to the entity
associate	An entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a subsidiary nor an interest in a joint venture.
balance sheet	Financial statement that presents the relationship of an entity's assets, liabilities and equity at a point in time
biological asset	A living animal or plant.

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borrowing costs Interest and other costs incurred by an entity in connection with the borrowing of funds.

business An integrated set of activities and assets conducted and managed for the purpose of providing:

(a) a return to investors; or

(b) lower costs or other economic benefits directly and proportionately to policyholders or participants.

A business generally consists of inputs, processes applied to those inputs, and resulting outputs that are, or will be, used to generate revenues. If goodwill is present in a transferred set of activities and assets, the transferred set shall be presumed to be a business.

business combination The bringing together of separate entities or businesses into one reporting entity.

carrying amount The amount at which an asset or liability is recognised in the balance sheet.

cash Cash on hand and demand deposits.

cash equivalent Short-term, highly liquid investments that are readily convertible to known amounts of cash and that are subject to an insignificant risk of changes in value.

cash flows Inflows and outflows of cash and cash equivalents.

cash flow statement Financial statement that provides information about the changes in cash and cash equivalents of an entity for a period, showing separately changes during the period from operating, investing and financing activities.

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cash-settled share-based payment transaction — A share-based payment transaction in which the entity acquires goods or services by incurring a liability to transfer cash or other assets to the supplier of those goods or services for amounts that are based on the price (or value) of the entity's shares or other equity instruments of the entity.

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 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 corrections of errors.

class of assets — A grouping of assets of a similar nature and use in an entity's operations.

combined financial statements — The financial statements of two or more entities controlled by a single shareholder.

component of an entity — Operations and cash flows that can be clearly distinguished, operationally and for financial reporting purposes, from the rest of the entity.

compound financial instrument — A financial instrument that, from the issuer's perspective, contains both a liability and an equity element.

consolidated financial statements — The financial statements of a group of entities consisting of a parent and one or more subsidiaries.

construction contract — A contract 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.

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constructive obligation An obligation that derives from an entity's actions where:

(a) by an established pattern of past practice, published policies or a sufficiently specific current statement, the entity has indicated to other parties that it will accept certain responsibilities; and

(b) as a result, the entity has created a valid expectation on the part of those other parties that it will discharge those responsibilities.

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.

contingent liability

(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 recognised because:

   (i) it is not probable that an outflow of resources embodying economic benefits will be required to settle the obligation; or

   (ii) the amount of the obligation cannot be measured with sufficient reliability.

control (of an entity) The power to govern the financial and operating policies of an entity so as to obtain benefits from its activities.

current tax The amount of income taxes payable (recoverable) in respect of the taxable profit (tax loss) for the current period.

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deductible temporary differences	Temporary differences that will result in amounts that are deductible in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.
deferred tax expense (income)	The amount of tax expense (income) included in the determination of profit or loss for the period in respect of changes in deferred tax assets and deferred tax liabilities during the period.
deferred tax assets	The amounts of income taxes potentially recoverable in future periods in respect of: (a) deductible temporary differences; (b) the carryforward of unused tax losses; and (c) the carryforward of unused tax credits.
deferred tax liabilities	The amounts of income taxes payable in future periods in respect of taxable temporary differences.
defined benefit liability	The present value of the defined benefit obligation at the reporting date minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly.
defined benefit obligation (present value of)	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.
defined benefit plans	Post-employment benefit plans other than defined contribution plans.
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 or constructive obligation to pay further contributions or to make direct benefit payments to employees if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

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depreciable amount The cost of an asset, or other amount substituted for cost (in the financial statements), less its residual value.

depreciation The systematic allocation of the depreciable amount of an asset over its useful life.

derecognition The removal of a previously recognised asset or liability from an entity's balance sheet.

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.

discontinued operation A component of an entity that either has been disposed of, or is classified as held for sale, and

(a) represents a separate major line of business or geographical area of operations,

(b) is part of a single coordinated plan to dispose of a separate major line of business or geographical area of operations or

(c) is a subsidiary acquired exclusively with a view to resale.

disposal group A group of assets to be disposed of, by sale or otherwise, together as a group in a single transaction, and liabilities directly associated with those assets that will be transferred in the transaction.

effective interest method A method of calculating the amortised cost of a financial asset or a financial liability (or a group of financial assets or financial liabilities) and of allocating the interest income or interest expense over the relevant period.

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effective interest rate 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.

effectiveness of a hedge 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.

elements of financial statements Broad classes of the financial effects of transactions and other events and conditions.

(a) The elements directly related to the measurement of financial position are assets, liabilities and equity.

(b) The elements directly related to the measurement of performance are income and expenses.

employee benefits All forms of consideration given by an entity in exchange for service rendered by employees.

equity The residual interest in the assets of the entity after deducting all its liabilities.

equity-settled share-based payment transaction A share-based payment transaction in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options).

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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 authorised 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.

expenses Decreases in economic benefits during the reporting period in the form of outflows or depletions of assets or incurrences of liabilities that result in decreases in equity, other than those relating to distributions to equity participants.

fair presentation Faithful representation of the effects of transactions, other events and conditions in accordance with the definitions and recognition criteria for assets, liabilities, income and expenses.

fair value The amount for which an asset could be exchanged, a liability settled, or an equity instrument granted could be exchanged, between knowledgeable, willing parties in an arm's length transaction.

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. A lease that is not a finance lease is an operating lease.

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financial asset 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 favourable to the entity; or

(d) a contract that will or may be settled in the entity's own equity instruments and that:

(i) the entity is or may be obliged to receive a variable number of the entity's own equity instruments; or

(ii) 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 instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

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

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financial liability

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 unfavourable to the entity; or

(b) a contract that will or may be settled in the entity's own equity instruments and:

(i) under which the entity is or may be obliged to deliver a variable number of the entity's own equity instruments; or

(ii) 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 instruments that are themselves contracts for the future receipt or delivery of the entity's own equity instruments.

financial position

The relationship of the assets, liabilities and equity of an entity as reported in the balance sheet.

financial statements

Structured representation of the financial position, financial performance and cash flows of an entity.

financing activities

Activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

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.

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first-time adopter of the *IFRS for SMEs*	An entity that presents its first annual financial statements that conform to the *IFRS for SMEs*, regardless of whether its previous accounting framework was full IFRSs or another set of accounting standards.
forecast transaction	An uncommitted but anticipated future transaction.
full IFRSs	International Financial Reporting Standards (IFRSs) other than the *IFRS for SMEs*.
functional currency	The currency of the primary economic environment in which the entity operates.
gains	Increases in economic benefits that meet the definition of income but that are not revenue.
general purpose financial statements	Financial statements directed toward the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large.
going concern	An entity is a going concern unless management either intends to liquidate the entity or to cease trading, or has no realistic alternative but to do so.
goodwill	Future economic benefits arising from assets that are not capable of being individually identified and separately recognised.
government grants	Assistance by government in the form of transfers of resources to an entity in return for past or future compliance with certain conditions relating to the operating activities of the entity.

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grant date The date at which the entity and another party (including an employee) agree to a share-based payment arrangement, being when the entity and the counterparty have a shared understanding of the terms and conditions of the arrangement. At grant date the entity confers on the counterparty the right to cash, other assets, or equity instruments of the entity, provided the specified vesting conditions, if any, are met. If that agreement is subject to an approval process (for example, by shareholders), grant date is the date when that approval is obtained.

hedged item For the purpose of special hedge accounting for SMEs under Section 11 of this [draft] standard, a hedged item is:

(a) interest rate risk exposure in a debt instrument measured at amortised cost;

(b) the foreign exchange risk exposure in a firm commitment or a highly probable forecast transaction;

(c) the price risk exposure in a commodity that it holds or in a firm commitment or highly probable forecast transaction to purchase or sell a commodity that has a readily determinable market price; or

(d) the foreign exchange risk exposure in a net investment in a foreign operation.

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hedging instrument For the purpose of special hedge accounting for SMEs under Section 11 of this [draft] standard, a hedging instrument is a financial instrument that:

(a) is an interest rate swap that meets the conditions in paragraph 11.33; a foreign currency swap or a foreign currency forward exchange contract that is indexed to the same foreign currency as the hedged item; or a forward contract that is indexed to the same commodity as the commodity that is the hedged item; and

(b) meets the other conditions in paragraph 11.32. An entity that chooses to apply IAS 39 in accounting for financial instruments shall apply the definition of hedging instrument in that standard rather than this definition.

held-for-sale asset Asset whose carrying amount will be recovered principally through a sale transaction rather than through continuing use.

highly probable Significantly more likely than probable.

impairment loss The amount by which the carrying amount of an asset exceeds (a) in the case of inventories, its selling price less costs to complete and sell or (b) in the case of other non-financial assets, its fair value less costs to sell.

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

imputed rate of interest The more clearly determinable of either:

(a) the prevailing rate for a similar instrument of an issuer with a similar credit rating; or

(b) a rate of interest that discounts the nominal amount of the instrument to the current cash sales price of the goods or services.

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income Increases in economic benefits during the reporting period in the form of inflows or enhancements of assets or decreases of liabilities that result in increases in equity, other than those relating to contributions from equity participants.

income statement Financial statement that presents information about the performance of an entity for a period, ie the relationship of its income and expenses.

income taxes All domestic and foreign taxes that are based on taxable profits. Income taxes also include taxes, such as withholding taxes, that are payable by a subsidiary, associate or joint venture on distributions to the reporting entity.

insurance contract A contract under which one party (the insurer) accepts significant insurance risk from another party (the policyholder) by agreeing to compensate the policyholder if a specified uncertain future event (the insured event) adversely affects the policyholder.

intangible asset An identifiable non-monetary asset without physical substance. Such an asset is identifiable when it:

(a) is separable, ie 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, asset or liability; or

(b) arises from contractual or other legal rights, regardless of whether those rights are transferable or separable from the entity or from other rights and obligations.

interim financial report A financial report containing either a complete set of financial statements or a set of condensed financial statements for an interim period.

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interim period A financial reporting period shorter than a full financial year.

International Financial Reporting Standards (IFRSs) Standards and Interpretations adopted by the International Accounting Standards Board (IASB). They comprise:

(a) International Financial Reporting Standards;

(b) International Accounting Standards; and

(c) Interpretations originated by the International Financial Reporting Interpretations Committee (IFRIC) or the former Standing Interpretations Committee (SIC).

intrinsic value The difference between the fair value of the shares to which the counterparty has the (conditional or unconditional) right to subscribe or which it has the right to receive, and the price (if any) the counterparty is (or will be) required to pay for those shares. For example, a share option with an exercise price of CU15, on a share with a fair value of CU20, has an intrinsic value of CU5.

inventories Assets:

(a) held for sale in the ordinary course of business;

(b) in the process of production for such sale; or

(c) in the form of materials or supplies to be consumed in the production process or in the rendering of services.

investing activities The acquisition and disposal of long-term assets and other investments not included in cash equivalents.

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investment property Property (land or a building, or part of a building, or both) held (by the owner or by the lessee under a finance lease) to earn rentals or for capital appreciation or both, rather than for:

(a) use in the production or supply of goods or services or for administrative purposes; or

(b) sale in the ordinary course of business.

joint control The contractually agreed sharing of control over an economic activity. It exists only when the strategic financial and operating decisions relating to the activity require the unanimous consent of the parties sharing control (the venturers).

joint venture A contractual arrangement whereby two or more parties undertake an economic activity that is subject to joint control. Joint ventures can take the form of jointly controlled operations, jointly controlled assets, or jointly controlled entities.

jointly controlled entity A joint venture that involves the establishment of a corporation, partnership or other entity in which each venturer has an interest. The entity operates in the same way as other entities, except that a contractual arrangement between the venturers establishes joint control over the economic activity of the entity.

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.

liability A present obligation of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits.

loans payable Financial liabilities other than short-term trade payables on normal credit terms.

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material	Omissions or misstatements of items are material if they could, individually or collectively, influence the economic decisions of users taken 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 size or nature of the item, or a combination of both, could be the determining factor.
measurement	The process of determining the monetary amounts at which the elements of the financial statements are to be recognised and carried in the balance sheet and income statement.
minority interest	That portion of the profit or loss and net assets of a subsidiary attributable to equity interests that are not owned, directly or indirectly through subsidiaries, by the parent.
multi-employer (benefit) plans	Defined contribution plans (other than state plans) or defined benefit plans (other than state plans) that: (a) pool the assets contributed by various entities that are not under common control; and (b) use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.
notes (to financial statements)	Notes contain information in addition to that presented in the balance sheet, income statement, statement of changes in 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.
notional amount	The quantity of currency units, shares, bushels, pounds or other units specified in a financial instrument contract.

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objective of financial statements	To provide information about the financial position, performance and cash flows of an entity that is useful for economic decision-making by a broad range of users who are not in a position to demand reports tailored to meet their particular information needs.
operating activities	The principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
operating lease	A lease that does not transfer substantially all the risks and rewards incidental to ownership. A lease that is not an operating lease is a finance lease.
operating segment	An operating segment is a component of an entity: (a) that engages in business activities from which it may earn revenues and incur expenses (including revenues and expenses relating to transactions with other components of the same entity), (b) whose operating results are regularly reviewed by the entity's chief operating decision maker to make decisions about resources to be allocated to the segment and assess its performance, and (c) for which discrete financial information is available.
parent	An entity that has one or more subsidiaries.
performance	The relationship of the income and expenses of an entity, as reported in the income statement.
plan assets (of an employee benefit plan)	(a) Assets held by a long-term employee benefit fund; and (b) qualifying insurance policies.
post-employment benefits	Employee benefits (other than termination benefits) that are payable after the completion of employment.

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post-employment benefit plans	Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.
present value	A current estimate of the present discounted value of the future net cash flows in the normal course of business.
presentation currency	The currency in which the financial statements are presented.
probable	More likely than not.
profit	The residual amount that remains after expenses have been deducted from income.
projected unit credit method	An actuarial valuation method that sees each period of service as giving rise to an additional unit of benefit entitlement and measures each unit separately to build up the final obligation (sometimes known as the accrued benefit method pro rated on service or as the benefit/years of service method).
property, plant and equipment	Tangible assets that: (a) are held for use in the production or supply of goods or services, for rental to others, for investment, or for administrative purposes, and (b) are expected to be used during more than one period.
prospective application (of a change in accounting policy)	Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed.
provision	A liability of uncertain timing or amount.

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prudence The inclusion of a degree of caution in the exercise of the judgements needed in making the estimates required under conditions of uncertainty, such that assets or income are not overstated and liabilities or expenses are not understated.

public accountability Accountability to those present and potential resource providers and others external to the entity who make economic decisions but who are not in a position to demand reports tailored to meet their particular information needs. An entity has public accountability if:

(a) it has issued (or is in the process of issuing) debt or equity instruments in a public market; or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance company, securities broker/dealer, pension fund, mutual fund or investment bank.

publicly traded registered with a securities commission or other regulatory organisation for the purpose of sale in a public market.

recognition The process of incorporating in the balance sheet or income statement an item that meets the definition of an element and that satisfies the following criteria:

(a) it is probable that any future economic benefit associated with the item will flow to or from the entity; and

(b) the item has a cost or value that can be measured with reliability.

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related party A party is related to an entity if:

(a) directly, or indirectly through one or more intermediaries, the party:

 (i) controls, is controlled by, or is under common control with, the entity (this includes parents, subsidiaries and fellow subsidiaries);

 (ii) has an interest in the entity that gives it significant influence over the entity; or

 (iii) has joint control over the entity;

(b) the party is an associate (as defined in IAS 28) of the entity;

(c) the party is a joint venture in which the entity is a venturer (see IAS 31);

(d) the party is a member of the key management personnel of the entity or its parent;

(e) the party is a close member of the family of any individual referred to in (a) or (d);

(f) the party is an entity that is controlled, jointly controlled or significantly influenced by, or for which significant voting power in such entity resides with, directly or indirectly, any individual referred to in (d) or (e); or

(g) the party is a post-employment benefit plan for the benefit of employees of the entity, or of any entity that is a related party of the entity.

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

relevance The quality of information that allows it to influence the economic decisions of users by helping them evaluate past, present or future events or confirming, or correcting, their past evaluations.

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reliability	The quality of information that makes it free from material error and bias and represent faithfully that which it either purports to represent or could reasonably be expected to represent.
reporting date	The end of the latest period covered by financial statements or by an interim financial report.
reporting period	The period covered by financial statements or by an interim financial report.
research	Original and planned investigation undertaken with the prospect of gaining new scientific or technical knowledge and understanding.
residual value (of an asset)	The estimated amount that an entity would currently obtain from disposal of an 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.
retrospective application (of a change in accounting policy)	Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.
revenue	The gross inflow of economic benefits during the period arising in the course of the ordinary activities of an entity when those inflows result in increases in equity, other than increases relating to contributions from equity participants.
separate financial statements	Those presented by a parent, 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 equity interest rather than on the basis of the reported results and net assets of the investees. If an investor in an associate or a venturer in a jointly controlled entity is not also a parent, its financial statements are not separate financial statements.

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share-based payment transaction A transaction in which the entity receives goods or services as consideration for equity instruments of the entity (including shares or share options), or acquires goods or services by incurring liabilities to the supplier of those goods or services for amounts that are based on the price of the entity's shares or other equity instruments of the entity.

small and medium-sized entities (SMEs) SMEs are entities that:

(a) do not have public accountability; and

(b) publish general purpose financial statements for external users.

state (employee benefit) plan Employee benefit plans established by legislation to cover all entities (or all entities in a particular category, for example a specific industry) and operated by national or local government or by another body (for example an autonomous agency created specifically for this purpose) which is not subject to control or influence by the reporting entity.

statement of changes in equity Financial statement that presents the profit or loss for a period, items of income and expense recognised directly in equity for the period, the effects of changes in accounting policy and corrections of errors recognised in the period, and (depending on the format of the statement of changes in equity chosen by the entity) the amounts of transactions with equity holders acting in their capacity as equity holders during the period.

statement of income and retained earnings Financial statement that presents the profit or loss and changes in retained earnings for a period.

substantively enacted Tax rates shall be regarded as substantively enacted when future events required by the enactment process will not change the outcome.

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

tax basis The measurement, under applicable existing tax law, of an asset, liability or equity instrument. That asset, liability, or equity instrument may be recognised for both tax and financial reporting purposes, for tax purposes but not for financial reporting, or for financial reporting purposes but not for tax.

tax expense (tax income) The aggregate amount included in the determination of profit or loss for the period in respect of current tax and deferred tax.

taxable profit (tax loss) The profit (loss) for a period, determined in accordance with the rules established by the taxation authorities, upon which income taxes are payable (recoverable)

taxable temporary differences Temporary differences that will result in taxable amounts in determining taxable profit (tax loss) of future periods when the carrying amount of the asset or liability is recovered or settled.

temporary differences Differences between the tax basis of an asset or liability and its carrying amount in the financial statements that will result in a taxable or deductible amount when the carrying amount of the asset or liability is recovered or settled. Temporary differences may be either taxable or deductible.

termination benefits Employee benefits payable as a result of either:

(a) an entity's decision to terminate an employee's employment before the normal retirement date; or

(b) an employee's decision to accept voluntary redundancy in exchange for those benefits.

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timing differences	Income or expenses that are recognised in profit or loss in one period but, under tax laws or regulations, are included in taxable income in a different period.
timeliness	Providing the information in financial statements within the decision time frame.
treasury shares	An entity's own equity instruments, held by the entity or other members of the consolidated group.
understandability	The quality of information in a way that makes it comprehensible by users who have a reasonable knowledge of business and economic activities and accounting and a willingness to study the information with reasonable diligence.
useful life	the period over which an asset is expected to be available for use by an entity or the number of production or similar units expected to be obtained from the asset by an entity.
vested benefits	Benefits, the rights to which, under the conditions of a retirement benefit plan, are not conditional on continued employment.

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DERIVATION TABLE

The [draft] *IFRS for SMEs* was developed by:

(a) extracting the fundamental concepts from the IASB *Framework* and the principles and related mandatory guidance from IFRSs (including Interpretations), and

(b) considering the modifications that are appropriate on the basis of users' needs and cost-benefit considerations.

The table below identifies the primary sources in full IFRSs from which the principles in each section of the [draft] *IFRS for SMEs* were derived.

Section in the [draft] ***IFRS for SMEs***		**Sources**
Preface		*Preface to International Financial Reporting Standards*
1	*Scope*	—
2	*Concepts and Pervasive Principles*	IASB *Framework*, IAS 1 *Presentation of Financial Statements*
3	*Financial Statement Presentation*	IAS 1
4	*Balance Sheet*	IAS 1
5	*Income Statement*	IAS 1
6	*Statement of Changes in Equity and Statement of Income and Retained Earnings*	IAS 1
7	*Cash Flow Statement*	IAS 7 *Cash Flow Statements*
8	*Notes to the Financial Statements*	IAS 1
9	*Consolidated and Separate Financial Statements*	IAS 27 *Consolidated and Separate Financial Statements*
10	*Accounting Policies, Estimates and Errors*	IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*
11	*Financial Assets and Financial Liabilities*	IAS 32 *Financial Instruments: Presentation*, IAS 39 *Financial Instruments: Recognition and Measurement*, IFRS 7 *Financial Instruments: Disclosures*
12	*Inventories*	IAS 2 *Inventories*
13	*Investments in Associates*	IAS 28 *Investments in Associates*
14	*Investments in Joint Ventures*	IAS 31 *Interests in Joint Ventures*

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Section in the [draft] *IFRS for SMEs*		Sources
15	*Investment Property*	IAS 40 *Investment Property*
16	*Property, Plant and Equipment*	IAS 16 *Property, Plant and Equipment*
17	*Intangible Assets other than Goodwill*	IAS 38 *Intangible Assets*
18	*Business Combinations and Goodwill*	IFRS 3 *Business Combinations*
19	*Leases*	IAS 17 *Leases*
20	*Provisions and Contingencies*	IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*
21	*Equity*	IAS 1, IAS 32
22	*Revenue*	IAS 11 *Construction Contracts*, IAS 18 *Revenue*
23	*Government Grants*	IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance*
24	*Borrowing Costs*	IAS 23 *Borrowing Costs*
25	*Share-based Payment*	IFRS 2 *Share-based Payment*
26	*Impairment of Non-financial Assets*	IAS 2, IAS 36 *Impairment of Assets*
27	*Employee Benefits*	IAS 19 *Employee Benefits*
28	*Income Taxes*	IAS 12 *Income Taxes*
29	*Financial Reporting in Hyperinflationary Economies*	IAS 29 *Financial Reporting in Hyperinflationary Economies*
30	*Foreign Currency Translation*	IAS 21 *The Effects of Changes in Foreign Exchange Rates*
31	*Segment Reporting*	IFRS 8 *Operating Segments*
32	*Events after the End of the Reporting Period*	IAS 10 *Events after the Balance Sheet Date*
33	*Related Party Disclosures*	IAS 24 *Related Party Disclosures*
34	*Earnings per Share*	IAS 33 *Earnings per Share*

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Section in the [draft] ***IFRS for SMEs***		Sources
35	*Specialised Industries*	IAS 41 *Agriculture*, IFRS 4 *Insurance Contracts*, IFRS 6 *Exploration for and Evaluation of Mineral Resources*
36	*Discontinued Operations and Assets Held for Sale*	IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*
37	*Interim Financial Reporting*	IAS 34 *Interim Financial Reporting*
38	*Transition to the* IFRS for SMEs	IFRS 1 *First-time Adoption of International Financial Reporting Standards*

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Basis for Conclusions on Exposure Draft

INTERNATIONAL FINANCIAL REPORTING STANDARD FOR SMALL AND MEDIUM-SIZED ENTITIES

Comments to be received by 1 October 2007

This Basis for Conclusions accompanies the Exposure Draft of the proposed *International Financial Reporting Standard for Small and Medium-sized Entities* (see separate booklet). Comments on the draft standard and its accompanying documents should be sent in writing so as to be received by **1 October 2007**. Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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Basis for Conclusions on Draft *International Financial Reporting Standard for Small and Medium-sized Entities*

This Basis for Conclusions accompanies, but is not part of, the draft standard.

Background

BC1 In its transition report of December 2000 to the newly formed International Accounting Standards Board (IASB), the outgoing Board of the International Accounting Standards Committee said 'A demand exists for a special version of International Accounting Standards for Small Enterprises.'

BC2 Shortly after its inception in 2001, the IASB began a project to develop accounting standards suitable for small and medium-sized entities (SMEs). The Board set up a Working Group of experts to provide advice on the issues and alternatives and potential solutions.

BC3 In their 2002 annual report, the Trustees of the IASC Foundation, under which the IASB operates, wrote 'The Trustees also support efforts by the IASB to examine issues particular to emerging economies and to small and medium-sized entities.' In July 2005 the Trustees formalised their support by restating the objectives of the Foundation and the IASB as set out in the Foundation's Constitution. They added an objective that, in developing IFRSs, the IASB should take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies. Similarly, the Standards Advisory Council has consistently encouraged the Board to pursue the project.

BC4 At public meetings of the Board during the second half of 2003 and early 2004, the Board developed some preliminary and tentative views about the basic approach that it would follow in developing IASB accounting standards for SMEs. It tested that approach by applying it to several IFRSs.

Discussion Paper (June 2004)

BC5 In June 2004, the Board published a Discussion Paper *Preliminary Views on Accounting Standards for Small and Medium-sized Entities* setting out and inviting comments on the Board's approach. The Board received 120 responses.

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BC6 The major issues set out in the Discussion Paper were:

(a) Should the IASB develop special financial reporting standards for SMEs?

(b) What should be the objectives of a set of financial reporting standards for SMEs?

(c) For which entities would IASB standards for SMEs be intended?

(d) If IASB standards for SMEs do not address a particular accounting recognition or measurement issue confronting an entity, how should that entity resolve the issue?

(e) May an entity using IASB standards for SMEs elect to follow a treatment permitted in an IFRS that differs from the treatment in the related IASB standard for SMEs?

(f) How should the Board approach the development of IASB standards for SMEs? To what extent should the foundation of SME standards be the concepts and principles and related mandatory guidance in IFRSs?

(g) If IASB standards for SMEs are built on the concepts and principles and related mandatory guidance in full IFRSs, what should be the basis for modifying those concepts and principles for SMEs?

(h) In what format should IASB standards for SMEs be published?

BC7 At its meetings later in 2004, the Board considered the issues raised by respondents to the Discussion Paper. In December 2004 and January 2005, the Board made some tentative decisions on the appropriate way forward for the project. The responses to the Discussion Paper showed a clear demand for an International Financial Reporting Standard for SMEs (IFRS for SMEs) and a preference, in many countries, to adopt the IFRS for SMEs rather than locally or regionally developed standards. The Board therefore decided to publish an exposure draft of an IFRS for SMEs as the next step.

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Recognition and measurement questionnaire and public round tables

BC8 Most respondents to the Discussion Paper said that recognition and measurement simplifications were needed, but few specifics were proposed. And when some specifics were proposed, the commentators generally did not indicate the particular transactions or other events or conditions that create the recognition or measurement problem for SMEs under IFRSs or how that problem might be solved.

BC9 The IASB concluded that it needed further information to assess possible recognition and measurement simplifications. Consequently the Board decided to hold public round-table meetings with preparers and users of the financial statements of SMEs to discuss possible modifications of the recognition and measurement principles in IFRSs for use in an IFRS for SMEs. The Board instructed the staff to develop and publish a questionnaire as a tool to identify issues that should be discussed at those round-table meetings.

BC10 The questionnaire (published April 2005) asked two questions:

1. What are the areas for possible simplification of recognition and measurement principles for SMEs?
2. From your experience, please indicate which topics addressed in IFRSs might be omitted from SME standards because they are unlikely to occur in an SME context. If they occur, the standards would require the SME to determine its appropriate accounting policy by looking to the applicable IFRSs.

BC11 The Board received 101 responses to the questionnaire. Those responses were discussed with the Standards Advisory Council (June 2005), with the SME Working Group (June 2005), World Standard-Setters (September 2005) and at the public round tables held by the Board in October 2005. A total of 43 groups participated in the round-table discussions with the Board over a two-day period.

Board deliberations

BC12 The IASB's Working Group met in June 2005 and made a comprehensive set of recommendations to the Board regarding the recognition, measurement, presentation and disclosure requirements that should be included in an exposure draft of an IFRS for SMEs. Later in 2005, the

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Board considered those recommendations and the views expressed in the responses to the Discussion Paper and the questionnaire, and at the round tables. During those deliberations, the Board made tentative decisions about the requirements to be included in the exposure draft.

BC13 On the basis of those tentative decisions, at the Board meeting in January 2006 the staff presented a preliminary draft of the exposure draft. The Working Group met in late January 2006 to review that draft and prepared a report of its recommendations for Board consideration. Board discussion of the draft began in February 2006 and continued through the remainder of 2006. Revised drafts of the exposure draft were prepared for each Board meeting from May onwards.

BC14 This Basis for Conclusions sets out the principal issues addressed by the Board, the alternatives considered, and the Board's reasons for accepting some alternatives and rejecting others.

Why global financial reporting standards for SMEs?

BC15 Global financial reporting standards, applied consistently, enhance the comparability of financial information. Accounting differences can obscure the comparisons that investors, lenders and others make. By resulting in the presentation of high quality comparable financial information, high quality global financial reporting standards improve the efficiency of allocation and the pricing of capital. This benefits not only those who provide debt or equity capital but also those entities that seek capital because it reduces their compliance costs and removes uncertainties that affect their cost of capital. Global standards also improve consistency in audit quality and facilitate education and training.

BC16 The benefits of global financial reporting standards are not limited to entities whose securities are traded in public capital markets. In the Board's judgement, small and medium-sized entities—and those who use their financial statements—can benefit from a common set of accounting standards. SMEs' financial statements that are comparable from one country to the next are needed for the following reasons:

(a) Financial institutions make loans across borders and operate multinationally. In most jurisdictions, over half of all SMEs, including the very small ones, have bank loans. Bankers rely on financial statements in making lending decisions and in establishing terms and interest rates.

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(b) Vendors want to evaluate the financial health of buyers in other countries before they sell goods or services on credit.

(c) Credit rating agencies try to develop ratings uniformly across borders. Similarly, banks and other institutions that operate across borders often develop ratings in a manner similar to credit rating agencies. Reported financial figures are crucial to the rating process.

(d) Many SMEs have overseas suppliers and use a supplier's financial statements to assess the prospects of a viable long-term business relationship.

(e) Venture capital firms provide funding to SMEs across borders.

(f) Many SMEs have outside investors who are not involved in the day-to-day management of the entity. Global accounting standards for general purpose financial statements and the resulting comparability are especially important when those outside investors are located in a different jurisdiction from the entity and when they have interests in other SMEs.

Should the IASB develop standards for SMEs?

BC17 In deciding to develop an IFRS for SMEs, the IASB was mindful of the following issues:

(a) Should financial reporting standards for SMEs be developed by others?

(b) Do national standard-setters support the IASB developing an IFRS for SMEs?

(c) Is developing an IFRS for SMEs consistent with the Board's mission?

(d) Existing IFRSs make some distinctions for SMEs.

Should others do it?

BC18 The Board considered whether financial reporting standards for SMEs would best be developed by others—either globally, country by country, or perhaps at a regional level—while the IASB focused its efforts primarily on standards for entities that participate in public capital markets. However, the Board noted that its mission, as set out in its Constitution (see paragraph BC21), is not restricted to standards for entities that participate in public capital markets. Focusing only on those entities is likely to result in standards or practices for other entities (including

SMEs) that may not address the needs of external users of financial statements, are not consistent with the IASB's *Framework for the Preparation and Presentation of Financial Statements* or standards, may lack comparability across national boundaries or within a country, and may not allow for an easy transition to full IFRSs for entities that wish to enter the public capital markets. For those reasons, the Board decided to undertake the project.

Do national standard-setters support an IASB initiative?

BC19 National accounting standard-setters throughout the world support the IASB's initiative. In September 2003 the IASB hosted a meeting of the world's national accounting standard-setters. In preparation for that meeting the Board surveyed them about standards for SMEs. With near-unanimity, the standard-setters that responded said that the IASB should develop global standards for SMEs.

BC20 The Board discussed the progress on its project on standards for SMEs at subsequent meetings of the world's national accounting standard-setters in 2004–2006. Standard-setters continued to support the Board's project.

An IFRS for SMEs is consistent with the IASB's mission

BC21 Developing a set of standards for SMEs is consistent with the IASB's mission. The principal objective of the IASB, as set out in its Constitution and in the *Preface to International Financial Reporting Standards*, is 'to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the various capital markets of the world and other users of the information to make economic decisions'. 'Single set' means that all entities in similar circumstances globally should follow the same standards. The circumstances of SMEs can be different from those of larger, publicly accountable entities in several ways, including:

(a) the users of the entity's financial statements and their information needs;

(b) how the financial statements are used;

(c) the depth and breadth of accounting expertise available to the entity; and

(d) SMEs' ability to bear the costs of following the same standards as the larger, publicly accountable entities.

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Existing IFRSs include some differences for non-public entities

BC22 IFRSs include several differences for entities whose securities are not publicly traded. For example:

(a) IFRS 8 *Operating Segments* requires disclosure of segment information only by entities whose debt or equity instruments are traded or registered for trading in a public market.

(b) IAS 27 *Consolidated and Separate Financial Statements* exempts some parent entities from preparing consolidated financial statements if their debt or equity instruments are not traded in a public market. Similar exemptions are in IAS 28 *Investments in Associates* and IAS 31 *Interests in Joint Ventures*.

(c) IAS 33 *Earnings per Share* requires presentation of earnings per share data only by entities whose ordinary shares or potential ordinary shares are publicly traded.

Different users' needs and cost-benefit considerations

BC23 The *Framework* (paragraph 12) states:

> The objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions.

In establishing standards for the form and content of general purpose financial statements, the needs of users of financial statements are paramount.

BC24 Users of financial statements of SMEs may have less interest in some information in general purpose financial statements prepared in accordance with full IFRSs than users of financial statements of entities whose securities are listed for trading in public securities markets or that otherwise have public accountability. For example, users of financial statements of SMEs may have greater interest in short-term cash flows, liquidity, balance sheet strength and interest coverage, and in the historical trends of earnings and interest coverage, than they do in information that is intended to assist in making forecasts of an entity's long-term cash flows, earnings and value. However, users of financial statements of SMEs may need some information that is not ordinarily presented in the financial statements of listed entities. For example, as

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an alternative to the public capital markets, SMEs often obtain capital from shareholders, directors and suppliers, and shareholders and directors often pledge personal assets so that the SME can obtain bank financing.

BC25 In the Board's judgement, the nature and degree of the differences between full IFRSs and an IFRS for SMEs must be determined on the basis of users' needs and cost-benefit analyses. In practice, the benefits of applying accounting standards differ across reporting entities, depending primarily on the nature, number and information needs of the users of their financial statements. The related costs may not differ significantly. Therefore, consistently with the *Framework*, the Board believed that the cost-benefit trade-off should be assessed in relation to the information needs of the users of an entity's financial statements.

BC26 The Board faced a dilemma in deciding whether to develop an IFRS for SMEs. On the one hand, it believed that the same concepts of financial reporting are appropriate for all entities regardless of public accountability—particularly the concepts for recognising and measuring assets, liabilities, income and expenses. This suggested that a single set of accounting standards should be suitable for all entities, although it would not rule out disclosure differences based on users' needs and cost-benefit considerations. On the other hand, the Board acknowledged that differences in the types and needs of users of SMEs' financial statements, as well as limitations in, and the cost of, the accounting expertise available to SMEs, suggested that separate standards for SMEs are appropriate. Those separate standards could include constraints such as linkage back to the *Framework*, consistent definitions of elements of financial statements and focus on the needs of users of financial statements of SMEs. On balance, the Board concluded that the latter approach (separate standards) was appropriate.

Adoption of an IFRS for SMEs does not imply that full IFRSs are not appropriate for SMEs

BC27 The Board believes that the objective of financial statements as set out in the *Framework* is appropriate for SMEs as well as for entities required to apply full IFRSs. The objective of providing information about the financial position, performance and changes in financial position of an entity that is useful to a wide range of users in making economic decisions is applicable without regard to the size of the reporting entity. Therefore, standards for general purpose financial statements of entities with public accountability would result in financial statements that meet

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the needs of users of financial statements of all entities, including those without public accountability. The Board is aware of research that shows that over 50 jurisdictions currently require or permit SMEs to use full IFRSs.

The objective of the proposed *IFRS for SMEs*

Why determination of taxable income and determination of distributable income are not specific objectives of the proposed *IFRS for SMEs*

BC28 IFRSs are designed to apply to the general purpose financial statements and other financial reporting of all profit-oriented entities. General purpose financial statements are directed towards the common information needs of a wide range of users, for example, shareholders, creditors, employees and the public at large. General purpose financial statements are intended to meet the needs of users that are not in a position to demand reports tailored to their particular information needs. General purpose financial statements provide information about an entity's financial position, performance and cash flows.

BC29 Determining taxable income requires special purpose financial statements—ones designed to comply with the tax laws and regulations in a particular jurisdiction. Similarly, an entity's distributable income is defined by the laws and regulations of the country or other jurisdiction in which it is domiciled.

BC30 Tax authorities are also often important external users of the financial statements of SMEs. Almost invariably, tax authorities have the power to demand whatever information they need to meet their statutory tax assessment and collection obligations. Tax authorities often look to financial statements as the starting point for determining taxable income, and some have policies to minimise the adjustments to accounting profit or loss for the purpose of determining taxable income. Nonetheless, global accounting standards for SMEs cannot deal with tax reporting in individual jurisdictions. But profit or loss determined in conformity with the proposed *IFRS for SMEs* can serve as the starting point for determining taxable income in a given jurisdiction by means of a reconciliation that is easily developed at a national level. A similar reconciliation can be developed to adjust profit or loss as measured by the proposed *IFRS for SMEs* to distributable income under national laws or regulations.

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Why it is not the purpose of the proposed *IFRS for SMEs* to provide information to owner-managers to help them make management decisions

BC31 Owner-managers use SMEs' financial statements for many purposes. However, it is not the purpose of the proposed *IFRS for SMEs* to provide information to owner-managers to help them make management decisions. Managers can obtain whatever information they need to run their business. (The same is true for full IFRSs.) Nonetheless, general purpose financial statements will often also serve managers' needs by providing insights into the business's financial position, performance and cash flows.

BC32 SMEs often produce financial statements only for the use of owner-managers, or for tax reporting or other non-securities regulatory filing purposes. Financial statements produced solely for those purposes are not necessarily general purpose financial statements.

The entities for which the proposed *IFRS for SMEs* is intended and those for which it is not intended

BC33 One of the first issues confronting the Board was to describe the class of entities for which the proposed *IFRS for SMEs* would be intended. The Board recognised that, ultimately, decisions on which entities should use the *IFRS for SMEs* will rest with national regulatory authorities and standard-setters. However, a clear definition of the class of entity for which the *IFRS for SMEs* is intended is essential so that:

(a) the Board can decide on the standards that are appropriate for that class of entity, and

(b) national regulatory authorities, standard-setters, reporting entities and their auditors will be informed of the intended scope of applicability of the *IFRS for SMEs*.

In that way, jurisdictions will understand that there are some types of entities for which the proposed *IFRS for SMEs* is not intended.

BC34 In the Board's judgement, the proposed *IFRS for SMEs* is appropriate for an entity that does not have public accountability. An entity has public accountability (and therefore should use full IFRSs) if:

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(a) it files, or it is in the process of filing, its financial statements with a securities commission or other regulatory organisation for the purpose of issuing any class of instruments in a public market; or

(b) it holds assets in a fiduciary capacity for a broad group of outsiders, such as a bank, insurance entity, securities broker/dealer, pension fund, mutual fund or investment banking entity.

Entities whose securities are traded in a public market have public accountability

BC35 Public securities markets, by their nature, bring together entities that seek capital and investors who are not involved in managing the entity and who are considering whether to provide capital, and at what price. Although those public investors often provide longer-term risk capital, they do not have the power to demand the financial information they might find useful for investment decision making. They must rely on general purpose financial statements. An entity's decision to enter a public capital market makes it publicly accountable—and it must provide the outside investors with financial information. Governments recognise this public accountability by establishing laws, regulations and regulatory agencies that deal with market regulation and disclosures to investors in public securities markets.

Financial institutions have public accountability

BC36 Similarly, banks, insurance companies, securities broker/dealers, pension funds, mutual funds and investment bankers stand ready to hold and manage financial resources entrusted to them by a broad group of clients, customers or members who are not involved in the management of the entities. Because such an entity acts in a public fiduciary capacity, it is publicly accountable. In most cases, these institutions are regulated by laws and government agencies.

SMEs that provide an essential public service

BC37 In the Discussion Paper, the Board's tentative view was that, in addition to the two conditions cited in paragraph BC34, an entity also has public accountability if it is a public utility or similar entity that provides an essential public service.

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BC38 Most respondents to the Discussion Paper, and also the Working Group, pointed out that in many jurisdictions entities that provide public services can be very small—for example, refuse collection companies, water companies, local power generating or distribution companies, and local cable television companies. Respondents argued that the nature of the users of the financial statements, rather than the nature of the business activity, should determine whether full IFRSs should be required. The Board concurred.

SMEs that are economically significant in their home jurisdiction

BC39 In the Discussion Paper, the Board's tentative view was that, in addition to the two conditions cited in paragraph BC34, an entity also has public accountability if it is economically significant in its home country on the basis of criteria such as total assets, total income, number of employees, degree of market dominance and nature and extent of external borrowings.

BC40 Most respondents, and the Working Group, argued that economic significance does not automatically result in public accountability. Public accountability, as that term is used in paragraphs 1.1 and 1.2, refers to accountability to those present and potential resource providers and others external to the entity who make economic decisions but who are not in a position to demand reports tailored to meet their particular information needs. The Board concluded that economic significance may be more relevant to matters of political and societal accountability. Whether such accountability requires general purpose financial statements using full IFRSs is a matter best left to local jurisdictions to decide.

Approval by owners to use the proposed *IFRS for SMEs*

BC41 In the Discussion Paper, the Board's tentative view was that 100 per cent of the owners of a small or medium-sized entity must agree before the entity could use the proposed *IFRS for SMEs*. The objection of even one owner of an entity to the use of the *IFRS for SMEs* would be sufficient evidence of the need for that entity to prepare its financial statements on the basis of full IFRSs. Most respondents did not agree. In their view, an objection, or even a non-response, by one or a few shareholders does not

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make an entity publicly accountable. They thought that the two criteria of (a) publicly traded and (b) financial institution appropriately identify entities with public accountability. The Board found those arguments persuasive.

SMEs that are a subsidiary, associate or joint venture of an IFRS investor

BC42 In the Discussion Paper, the Board's tentative view was that if a subsidiary, joint venture or associate of an entity with public accountability prepares financial information in accordance with full IFRSs to meet the requirements of the parent, venturer or investor, it should be required to comply with full IFRSs, not the *IFRS for SMEs*, in its separate financial statements. In the Board's view, because the information in accordance with full IFRSs had been produced for other purposes, it would be more costly to prepare a second set of financial statements that comply with the *IFRS for SMEs*. Most respondents to the Discussion Paper did not agree. Many said that the IFRS data produced for consolidation or equity accounting purposes have a different materiality threshold from that necessary for the investee's own financial statements. Moreover, they said that the circumstances of the entity, rather than the circumstances of its parent or investor, should determine whether it has public accountability. Consequently, they argued, it would be costly and burdensome for the investee to have to apply full IFRSs in its own financial statements. The Board found those arguments persuasive. Therefore, SMEs should assess their eligibility to use the *IFRS for SMEs* on the basis of their own circumstances, even if they also submit financial information in accordance with full IFRSs to a parent, venturer or investor.

Quantified size criteria

BC43 The definition of SMEs does not include quantified size criteria for determining what is a small or medium-sized entity. The Board noted that its standards are used in over 100 countries. The Board concluded that it is not feasible to develop quantified size tests that would be applicable and long-lasting in all of those countries. This is consistent with the Board's general principle-based approach to standard-setting.

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BC44 In deciding which entities should be required or permitted to use the *IFRS for SMEs*, jurisdictions may prescribe quantified size criteria. Similarly, a jurisdiction may decide that entities that are economically significant in that country should be required to use full IFRSs rather than the *IFRS for SMEs*.

Suitability of the proposed *IFRS for SMEs* for very small entities—the so-called 'micros'

BC45 In deciding on the content of the proposed *IFRS for SMEs*, the IASB focused on a typical entity with about 50 employees. The Board used the 50-employee guideline not as a quantified size test for defining SMEs but, rather, to help it decide the kinds of transactions, events and conditions that should be explicitly addressed in the proposed *IFRS for SMEs*. The Board's goal in doing so was to make the *IFRS for SMEs* a stand-alone document for such typical SMEs, and also for entities smaller than 50 employees.

BC46 Some contend that an IFRS for SMEs that is designed to cover the typical transactions, events and conditions of SMEs with about 50 employees is not suitable for a very small 'micro' entity employing one, two or three people that is required, or elects, to publish general purpose financial statements for external users. The Board did not agree. External users such as lenders, vendors, customers, rating agencies and employees need specific types of information but are not in a position to demand reports tailored to meet their particular information needs. They must rely on general purpose financial statements. This is as true for micros as it is for larger SMEs. Financial statements prepared using the proposed *IFRS for SMEs* are intended to meet those needs.

BC47 Some who question whether the proposed *IFRS for SMEs* will be suitable for micros argue that many micro entities prepare financial statements solely to submit to income tax authorities for the purpose of determining taxable income. As explained more fully in paragraphs BC28–BC30, determining taxable income (and also determining legally distributable income) requires special purpose financial statements—ones designed to comply with tax laws and regulations in a particular jurisdiction.

BC48 Moreover, the Board noted that, in many countries, full IFRSs are required for all or most limited liability companies, including the micros. The Board also noted that many other countries permit the micros to use full IFRSs. As mentioned in paragraph BC27, well over 50 jurisdictions have decided that full IFRSs should be required or permitted for all entities, including micros. If full IFRSs have been judged suitable for all

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entities, then the proposed *IFRS for SMEs* will surely also be suitable. The guidance in the draft *IFRS for SMEs* is simple and straightforward. That guidance may cover some transactions or circumstances that micro SMEs do not typically encounter, but the Board did not believe that this imposes a burden on micro SMEs. The topical organisation of the proposed *IFRS for SMEs* will make it easy for micro SMEs to identify those aspects of the standard that are relevant to their circumstances.

BC49 Some favour a very simple and brief set of accounting requirements for micro SMEs—with broad principles of accrual basis accounting (some even suggest a cash basis or modified cash basis), specific recognition and measurement principles for only the most basic transactions, and requiring perhaps only a balance sheet and an income statement with limited note disclosures. The Board acknowledged that this approach might result in relatively low costs to SMEs in preparing financial statements. However, the Board concluded that the resulting statements would not meet the objective of decision-usefulness because they would not provide useful information about the entity's financial position, performance and changes in financial position that is useful to a wide range of users in making economic decisions. Moreover, the Board believed that financial statements prepared using such a simple and brief set of accounting requirements might not serve SMEs by improving their ability to obtain capital. Therefore, the Board concluded that it should not develop this type of IFRS for SMEs.

BC50 The IASB does not have the power to require any entity to use its standards. That is the responsibility of legislators and regulators. In some countries, the government has delegated that power to an independent standard-setter or to the professional accountancy body. They will have to decide which entities should be required or permitted to use, or perhaps prohibited from using, the *IFRS for SMEs*. The Board believes that the proposed *IFRS for SMEs* will be suitable for all entities that do not have public accountability, including micros.

The proposed *IFRS for SMEs* is not intended for small publicly-traded entities

BC51 Entities, large or small, whose debt or equity instruments are traded in public capital markets have chosen to seek capital from outside investors who are not involved in managing the business and who do not have the power to demand information that they might find useful. Full IFRSs have been designed to serve public capital markets by providing

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disclosures and guidance especially intended for investors and creditors in such markets. Some of those disclosures and some of that guidance is not included in the draft *IFRS for SMEs*. The Board concluded, therefore, that full IFRSs are appropriate for an entity with public accountability.

BC52 A jurisdiction that believes that the *IFRS for SMEs* is appropriate for small publicly traded entities in that jurisdiction could incorporate the requirements of the *IFRS for SMEs* into its national standards for small publicly-traded entities. In that case, however, the financial statements would be described as conforming to national GAAP. The draft IFRS for SMEs proposes to prohibit them from being described as conforming to the IFRS for SMEs.

'Small and medium-sized entities'

BC53 'Small and medium-sized entities' (SMEs) as used by the IASB is defined in Section 1 *Scope* of the draft *IFRS for SMEs*. Many jurisdictions have developed their own definitions of the term for a broad range of purposes including prescribing financial reporting obligations. Often those national or regional definitions include quantified criteria based on revenue, assets, employees or other factors. Frequently, the term is used to mean or to include very small entities without regard to whether they publish general purpose financial statements for external users.

BC54 The IASB considered whether to use another term, and used the term 'non-publicly accountable entity' (NPAE) for several months during 2005. Because the Board concluded that full IFRSs are necessary for entities with public accountability, the terms 'publicly accountable entity' and 'non-publicly accountable entity' had some appeal. However, constituents argued that this term is not widely recognised, whereas 'small and medium-sized entities' (SMEs) is universally recognised. Also, some said that 'non-publicly accountable entities' seemed to imply that the smaller entities were not accountable. Furthermore, in July 2005 the Trustees of the IASC Foundation restated the objectives of the Foundation and the IASB as set out in the Foundation's Constitution by adding objective (c), which uses the term 'small and medium-sized entities':

> The objectives of the IASC Foundation are:
>
> (a) to develop, in the public interest, a single set of high quality, understandable and enforceable global accounting standards that require high quality, transparent and comparable information in financial statements and other financial reporting to help participants in the world's capital markets and other users make economic decisions;

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(b) to promote the use and rigorous application of those standards;

(c) in fulfilling the objectives associated with (a) and (b), to take account of, as appropriate, the special needs of small and medium-sized entities and emerging economies; and

(d) to bring about convergence of national accounting standards and International Accounting Standards and International Financial Reporting Standards to high quality solutions.

For these reasons, the Board decided to use 'small and medium-sized entities'.

The users of SMEs' financial statements prepared using the proposed *IFRS for SMEs*

BC55 The proposed *IFRS for SMEs* is intended for non-publicly accountable entities that publish general purpose financial statements for external users. The main groups of external users include:

(a) banks that make loans to SMEs.

(b) vendors that sell to SMEs and use SMEs' financial statements to make credit and pricing decisions.

(c) credit rating agencies and others that use SMEs' financial statements to rate SMEs.

(d) customers of SMEs that use SMEs' financial statements to decide whether to do business.

(e) SMEs' shareholders that are not also managers of their SMEs.

The extent to which the proposed *IFRS for SMEs* should be a stand-alone document

BC56 As explained above, the proposed *IFRS for SMEs* is intended to be a stand-alone document for a typical small entity with about 50 employees. There will be occasions, however, when the *IFRS for SMEs* will require or permit entities to look to full IFRSs:

(a) When IFRSs provide an accounting policy option, the Board concluded that SMEs should have the same options. The simpler option is included in the draft *IFRS for SMEs* (see paragraphs BC108–BC115). The other option or options are permitted by cross-reference to IFRSs.

(b) The draft *IFRS for SMEs* omits some accounting topics that are addressed in full IFRSs, because the Board believes that typical SMEs are not likely to encounter such transactions (see paragraphs BC57–BC65). However, the draft has cross-references requiring SMEs that encounter such a transaction to look to a particular IFRS or to a section of one.

(c) The draft *IFRS for SMEs* states that if the standard does not address a transaction or other event or condition or provide a cross-reference back to another IFRS, an entity should select an accounting policy that results in relevant and reliable information. In making that judgement, an entity should consider, first, the requirements and guidance in the proposed *IFRS for SMEs* dealing with similar and related issues and, second, the definitions, recognition criteria and measurement concepts for assets, liabilities, income and expenses and the pervasive principles in Section 2 *Concepts and Pervasive Principles* of the draft standard. If that does not provide guidance, the entity may look to the requirements and guidance in IFRSs, including Interpretations of IFRSs, dealing with similar and related issues.

Topics covered in IFRSs that are omitted from the draft *IFRS for SMEs*

BC57 Some hold the view that the *IFRS for SMEs* should be completely stand-alone—that an entity applying it should never have to look to full IFRSs. The Board concluded that, for that to be the case, the *IFRS for SMEs* would have to be significantly longer than the draft because it would have to address those transactions and circumstances that SMEs sometimes, although not typically, encounter. Paragraphs BC58–BC65 identify the topics that are not covered in the draft *IFRS for SMEs*, but for which it includes a cross-reference to the relevant IFRS that an entity would be required to apply if it encountered the transaction or situation.

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Hyperinflation

BC58 Section 29 *Financial Reporting in Hyperinflationary Economies* would require SMEs whose functional currency is the currency of a hyperinflationary economy to apply IAS 29 *Financial Reporting in Hyperinflationary Economies* in preparing and presenting financial statements in accordance with the *IFRS for SMEs*. The draft *IFRS for SMEs* does not include requirements on reporting in hyperinflationary economies because it is uncommon for SMEs to have a hyperinflationary functional currency.

Equity-settled share-based payment

BC59 Section 25 *Share-based Payment* would require SMEs to apply IFRS 2 *Share-based Payment* in measuring equity-settled share-based payment transactions, and to make the relevant disclosures required by IFRS 2. The Board believes that it is uncommon for SMEs to enter into such transactions.

Agriculture

BC60 Section 35 *Specialised Industries* would require SMEs engaged in agricultural activities to apply the fair value model in paragraphs 10–29 of IAS 41 *Agriculture* to account for those biological assets whose fair value is readily determinable, and to make all related disclosures required by IAS 41. Although many entities that undertake agricultural activities are SMEs, typical SMEs are unlikely to undertake those activities.

Interim financial reporting

BC61 Section 37 *Interim Financial Reporting* would give SMEs that issue an interim financial report that is described as complying with the *IFRS for SMEs* a choice of applying either IAS 34 *Interim Financial Reporting* or all of the requirements of the proposed *IFRS for SMEs*. The Board concluded that most SMEs either would not issue interim financial reports or would issue interim financial reports that are not described as complying with the *IFRS for SMEs*.

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Lessor accounting for finance leases

BC62 Section 19 *Leases* would require SMEs that are a lessor in a finance lease to apply paragraphs 36–46 of IAS 17 *Leases* and to make the related disclosures required by IAS 17. Many lessors in a finance lease are likely to be financial institutions that are publicly accountable and, thus, would not be eligible to use the proposed *IFRS for SMEs*.

Earnings per share

BC63 Section 34 *Earnings per Share* would not require SMEs to present amounts of earnings per share. However, if SMEs chose to disclose earnings per share, Section 34 would require them to follow the requirements of IAS 33 *Earnings per Share*.

Segment reporting

BC64 Section 31 *Segment Reporting* would not require SMEs to present segment information. However, if SMEs chose to disclose segment information, Section 31 would require them to follow the requirements of IFRS 8 *Operating Segments*.

Insurance

BC65 Because an insurer holds assets in a fiduciary capacity for a broad group of outsiders, it has public accountability and is therefore outside the definition of SMEs in paragraph 1.1. The proposed *IFRS for SMEs* is not intended for, and would not be available for use by, insurers.

Why the *Framework* and principles and mandatory guidance in existing IFRSs are the appropriate starting point for developing the proposed *IFRS for SMEs*

BC66 The draft *IFRS for SMEs* was developed by:

(a) extracting the fundamental concepts from the *Framework* and the principles and related mandatory guidance from IFRSs (including Interpretations), and

(b) considering the modifications that are appropriate in light of users' needs and cost-benefit considerations.

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BC67 The Board judged that this approach is appropriate because the needs of users of financial statements of SMEs are similar in many ways to the needs of users of financial statements of publicly accountable entities. Therefore, full IFRSs are the logical starting point for developing an *IFRS for SMEs*.

BC68 The Board rejected the alternative 'fresh start' approach because that approach could have resulted in different objectives of financial reports, different qualitative characteristics of financial information, different definitions of the elements of financial statements, and different concepts of recognition and measurement. The Board concluded that a 'fresh start' approach would be costly and time-consuming and ultimately futile. This is because the Board is of the view that there is sufficient convergence of users' needs relative to the general purpose financial statements of entities with and without public accountability.

BC69 Several of the sections in the draft *IFRS for SMEs* relate to projects currently on the IASB's agenda. For several of those projects an exposure draft has been published. They include:

(a) Section 3 *Financial Statement Presentation* relates to the Exposure Draft of Proposed Amendments to IAS 1—*A Revised Presentation*.

(b) Section 18 *Business Combinations and Goodwill* relates to the Exposure Draft of Proposed Amendments to IFRS 3 *Business Combinations*.

(c) Section 20 *Provisions and Contingencies* relates to the Exposure Draft of Proposed Amendments to IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.

(d) Section 24 *Borrowing Costs* relates to the Exposure Draft of Proposed Amendments to IAS 23 *Borrowing Costs*.

(e) Glossary definitions of liabilities and equity relate to the Exposure Draft of Proposed Amendments to IAS 32 and IAS 1—*Financial Instruments Puttable at Fair Value and Obligations Arising on Liquidation*.

Because exposure drafts are proposals on which the IASB's due process is not yet complete, the starting point for developing the *IFRS for SMEs* is existing IFRSs that do not reflect the proposed changes under consideration.

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Recognition and measurement simplifications

BC70 Paragraphs BC71–BC93 explain the significant simplifications that the Board proposes to the recognition and measurement principles in IFRSs, and the reasons for the proposals. The Board also discussed other recognition and measurement simplifications but decided not to adopt them (see paragraphs BC94–BC107).

Financial instruments

BC71 Many said that the requirements of IAS 39 *Financial Instruments: Recognition and Measurement* are burdensome for SMEs. They cited as especially burdensome for SMEs the complexities of classifying financial instruments into four categories, the 'pass-through' and 'continuing involvement' tests for derecognition, and the detailed calculations required to qualify for hedge accounting. The Board agreed that simplifications of IAS 39 are appropriate for SMEs.

BC72 Much of the complexity in IAS 39 results from permitting entities to choose from a range of measurement attributes for financial instruments. Those choices reduce comparability and impose measurement complexity. The draft *IFRS for SMEs* enhances comparability and reduces complexity by defining a default measurement attribute and limiting the use of other measurement attributes.

BC73 Principal among the simplifications proposed in the draft *IFRS for SMEs* are the following:

(a) *Classification of financial instruments*. Financial instruments that meet specified criteria are measured at cost or amortised cost, and all others are measured at fair value through profit or loss. The available-for-sale and held-to-maturity classifications in IAS 39 are not available, thereby reducing the complexities associated with the two additional categories, including assessment of intentions, forecasts of cash flows, and accounting 'penalties' in some cases.

(b) *Derecognition*. The draft proposes a simple principle for derecognition. That principle does not rely on the 'pass-through' and 'continuing involvement' provisions that apply to derecognition under IAS 39. Those provisions are complex and relate to derecognition transactions in which SMEs are typically not engaged.

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(c) *Hedge accounting*. The draft focuses on the types of hedging that SMEs are likely to do, specifically hedges of:

- interest rate risk of a debt instrument measured at amortised cost;
- foreign exchange risk or interest rate risk in a firm commitment or a highly probable forecast transaction;
- price risk of a commodity that it holds or in a firm commitment or a highly probable forecast transaction to purchase or sell a commodity; or
- foreign exchange risk in a net investment in a foreign operation.

BC74 With regard to hedge accounting, the draft *IFRS for SMEs* would require periodic recognition and measurement of hedge ineffectiveness, but under less strict conditions than those in IAS 39. In particular, ineffectiveness is recognised and measured at the end of the financial reporting period, and hedge accounting is discontinued prospectively starting from that point, for hedges that no longer meet the conditions for hedge accounting. IAS 39 would require discontinuation of hedge accounting prospectively starting at the date the conditions were no longer met—a requirement that SMEs often say they find burdensome.

BC75 As an alternative to simplified effectiveness testing, the Board considered an approach that is in the US standard SFAS 133 *Accounting for Derivative Instruments and Hedging Activities* and is called the 'shortcut method'. Under such a method, the *IFRS for SMEs* would impose strict conditions on the designation of a hedging relationship with subsequent hedge effectiveness assumed without need for measuring ineffectiveness. The Board concluded that simplified effectiveness testing is preferable to the shortcut method for two principal reasons:

(a) Recognition of all hedge ineffectiveness in profit or loss is a basic principle of IAS 39. The shortcut method is inconsistent with that principle.

(b) To be able to assume that the possibility of hedge ineffectiveness is nil or insignificant, the key features of the hedging instrument and the hedged item, including the term, would have to match, and there could be no conditional terms. Consequently, hedge accounting would be prohibited if the hedging instrument is prepayable or puttable or has other early termination or extension features. Such a requirement would, in effect, make hedge

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accounting a practical impossibility for many, and perhaps most, SMEs.

BC76 Section 11 also differs from IAS 39 with respect to hedge accounting in the following ways:

(a) Hedge accounting cannot be achieved by using debt or equity instruments ('cash instruments') as hedging instruments. IAS 39 permits this for a hedge of a foreign currency risk. However, the same effect on profit or loss can be achieved by measuring the cash instrument at fair value, which Section 11 requires for some cash instruments and permits for others. SMEs typically sell the cash hedging instrument when the hedging relationship terminates.

(b) Hedge accounting cannot be achieved with an option-based hedging strategy. Because hedging with options involves incurring a cost, SMEs are more likely to use forward contracts as hedging instruments rather than options.

(c) Hedge accounting for portfolios is not permitted. Hedging portfolios adds considerable accounting complexity because of the need to remeasure all of the hedged items individually at fair value to ensure that the appropriate amounts are derecognised when the instrument is sold and to ensure that the amortisation is appropriate when an instrument is no longer being hedged.

The Board does not believe that these simplifications will affect SMEs adversely because these are not hedging strategies that are typical of SMEs.

BC77 Contracts to buy, sell, lease or insure a non-financial item such as a commodity, inventory, property, plant or equipment are accounted for as financial instruments within the scope of Section 11 if they could result in a loss to the buyer, seller, lessor, lessee or insured party as a result of contractual terms that are unrelated to changes in the price of the non-financial item, changes in foreign exchange rates, or a default by one of the counterparties. Such contracts are accounted for as financial instruments because their terms include a financial risk component that alters the settlement amount of the contract that is unrelated to the purchase or sale of, or leasing or insuring, the non-financial item.

BC78 Section 11 proposes to give SMEs a choice of following Section 11 or IAS 39 in accounting for all of their financial instruments. The Board's reasons for proposing that choice in this case are as follows:

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(a) Although Section 11 is a simpler approach to accounting for financial instruments than IAS 39, some of the simplifications involve eliminating options that are available to companies with public accountability under IAS 39, for instance:

  (i) available-for-sale classification and the available-for-sale option;

  (ii) held-to-maturity classification;

  (iii) a continuing involvement approach to derecognition (ie partial derecognition); and

  (iv) the use of hedge accounting for hedges other than the four specific types identified in paragraph BC73(c).

  In general, the draft *IFRS for SMEs* would permit SMEs to have the same accounting policy options as in full IFRSs.

(b) Because the proposed default category for financial instruments is fair value through profit and loss under the *IFRS for SMEs*, and cost or amortised cost is permitted only when specified conditions are met, some items measured at cost or amortised cost under IAS 39 because of their nature would be measured at fair value through profit or loss under the *IFRS for SMEs*. Some SMEs might find this added fair valuation burdensome.

(c) 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. Those entities generally believe that the available-for-sale classification of IAS 39 is appropriate to account for strategic investments. Under the draft *IFRS for SMEs*, however, these strategic investments would be accounted for at fair value through profit or loss.

(d) The derecognition provisions of the draft *IFRS for SMEs* would not result in derecognition for many securitisations and factoring transactions that SMEs may enter into, whereas IAS 39 would result in derecognition.

Goodwill impairment

BC79 In their responses to the recognition and measurement questionnaire and at the round-table meetings, many preparers and auditors of SMEs' financial statements said that the requirement in IFRS 3 *Business Combinations* for an annual calculation of the recoverable amount of goodwill is onerous for SMEs because of the expertise and cost involved. They proposed, as an alternative, that SMEs should be required to calculate the recoverable amount of goodwill only if impairment is indicated. They proposed, further, that the *IFRS for SMEs* should include a list of indicators of impairment of goodwill as guidance for SMEs. The Board agreed with those proposals. The draft *IFRS for SMEs* proposes an indicator approach and includes a list of indicators based on both internal and external sources of information.

BC80 Some respondents to the questionnaire and some of those who took part in the round-table discussions proposed requiring amortisation of goodwill over a specified maximum period. Proposals generally ranged from 10 to 20 years. They argued that amortisation is simpler than an impairment approach, even an impairment approach that is triggered by indicators. The Board did not agree with this proposal for three main reasons:

(a) An amortisation approach still requires assessment of impairment, so it is actually a more complex approach than an indicator-triggered assessment of impairment.

(b) Amortisation is the systematic allocation of the cost (or revalued amount) of an asset, less any residual value, to reflect the consumption over time of the future economic benefits embodied in that asset over its useful life. By its nature, goodwill often has an indefinite life. Thus, if there is no foreseeable limit on the period during which an entity expects to consume the future economic benefits embodied in an asset, amortisation of that asset over, for example, an arbitrarily determined maximum period would not faithfully represent economic reality.

(c) When the IASB was developing IFRS 3, and related amendments to IAS 38 *Intangible Assets*, most users of financial statements said they found little, if any, information content in the amortisation of goodwill over an arbitrary period of years.

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Treat all research and development costs as expenses

BC81 IAS 38 requires all research costs to be charged to expense when incurred, but development costs incurred after the project is deemed to be commercially viable are to be capitalised. Many preparers and auditors of SMEs' financial statements said that SMEs do not have the resources to assess whether a project is commercially viable on an ongoing basis and, furthermore, capitalisation of only a portion of the development costs does not provide useful information. Bank lending officers told the Board that information about capitalised development costs is of little benefit to them, and that they disregard those costs in making lending decisions.

BC82 The Board accepted those views, and the draft *IFRS for SMEs* proposes an accounting policy choice (not available under IAS 38) for treating all research and development costs as expenses. Alternatively, SMEs would be permitted to apply the requirements of IAS 38 by cross-reference to that IFRS.

Cost method for associates and joint ventures

BC83 IAS 28 requires an entity to account for its investments in associates by the equity method. IAS 31 allows an entity to account for its investments in jointly controlled entities by either the equity method or proportionate consolidation. Many preparers of SMEs' financial statements questioned the usefulness of both of those accounting methods and told the Board that SMEs have particular difficulty in applying those methods because of inability to obtain the required information and the need to conform accounting policies and reporting dates. In their view, the cost method—which is permitted under IAS 28 and IAS 31 in accounting for investments in associates and joint ventures in the investor's separate financial statements—should also be permitted under the *IFRS for SMEs* in the investor's consolidated financial statements. Lenders generally indicated that information reported using the equity method and proportionate consolidation is of limited use to them because it is not useful in assessing either future cash flows or loan security. Fair values are more relevant for those purposes. Recognising the special problems of SMEs in applying the equity and proportionate consolidation methods, and also the relevance of fair values for lenders, the Board concluded that SMEs should be permitted to use either the cost method or fair value through profit or loss.

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Income taxes—'timing differences plus' approach

BC84 In their responses to the questionnaire and at the round-table meetings, many preparers and auditors of SMEs' financial statements said that the temporary difference approach to accounting for income taxes in IAS 12 *Income Taxes* is difficult for SMEs to implement. They said that SMEs do not routinely prepare 'tax balance sheets' and generally do not track the tax bases of many assets. Some advocated a 'current taxes payable' method of accounting for income taxes, under which SMEs would not recognise deferred taxes.

BC85 The Board did not support the 'current taxes payable' approach for the reasons explained in paragraph BC102. However, while believing that the principle of recognising deferred tax assets and liabilities is appropriate for SMEs, the Board also concluded that implementation of that principle could be simplified for SMEs. Section 28 of the draft *IFRS for SMEs* uses the 'temporary difference approach' of IAS 12 for recognition of deferred taxes. However, it explains temporary differences in terms of 'timing differences', which many SMEs and their auditors indicated is not burdensome for SMEs, and adds requirements to recognise deferred taxes in several additional cases. With respect to the initial recognition of deferred taxes on the first-time adoption of the *IFRS for SMEs*, the draft proposes relief for SMEs if recognising the deferred taxes would involve undue cost or effort. Section 28 does not include an exception to recognition of deferred taxes on undistributed earnings of domestic subsidiaries, branches, associates and joint ventures because that exception is inconsistent with the simplified general principles in paragraphs 28.15 and 28.16.

Less fair value for agriculture

BC86 Some preparers and auditors of the financial statements of SMEs engaged in agricultural activities said that the 'fair value through profit or loss' model is burdensome for SMEs, particularly when applied to biological assets of those SMEs operating in inactive markets or developing countries. They said that the presumption in IAS 41 that fair value can be estimated for biological assets and agricultural produce is unrealistic with respect to biological assets of some SMEs. Some proposed that SMEs should be permitted or required to use a 'cost-depreciation-impairment' model for all such assets. The Board did not support this approach for the reasons explained in paragraph BC103. However, the Board concluded, both because of the measurement problems in inactive markets and developing countries and for cost-benefit reasons, that SMEs should be

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required to use the fair value through profit or loss model only when fair value is readily determinable without undue cost or effort. When that is not the case, the Board concluded that SMEs should follow the cost-depreciation-impairment model.

Employee benefits—defined benefit plans

BC87 The Board initially planned not to include in the proposed *IFRS for SMEs* any guidance on accounting for defined benefit plans, on the grounds that few SMEs have such plans. The *IFRS for SMEs* would have included a cross-reference to the requirements of IAS 19 *Employee Benefits* for those 'atypical' SMEs that had such plans. However, many people told the Board that in some countries the law requires SMEs to provide benefits to employees under terms that are equivalent to a defined benefit pension plan (eg long-service payments based on future salaries). They recommended that the *IFRS for SMEs* should include accounting requirements for such plans based on, but simplified from, those in IAS 19. The Board concurred.

BC88 One of the principal complexities of IAS 19 is recognition of actuarial gains and losses. Under IAS 19, an entity can:

(a) recognise actuarial gains and losses in full in profit or loss when they occur.

(b) recognise actuarial gains and losses in full directly in equity when they occur, but only if the entity presents those gains and losses in a statement titled 'statement of recognised income and expense' that does not include equity transactions with owners (ie not a traditional statement of changes in equity).

(c) amortise the excess of actuarial gains and losses over the greater of

   (i) 10 per cent of the present value of the defined benefit obligation at that date (before deducting plan assets) and

   (ii) 10 per cent of the fair value of any plan assets at that date

   (with those limits calculated and applied separately for each defined benefit plan) divided by the average remaining working life of the employees.

(d) recognise actuarial gains and losses in profit or loss using any systematic method that results in faster recognition than (c) above.

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BC89 The draft *IFRS for SMEs* proposes to require method (a)—immediate recognition in profit or loss. Of the four methods identified in the preceding paragraph, this is the simplest method for SMEs to implement. Method (b) requires preparation of a financial statement that most SMEs do not normally prepare. Methods (c) and (d) require tracking of data over many years and annual calculations. Moreover, financial statement users generally have told the Board that they find immediate recognition (method (a)) provides the most understandable and useful information, in addition to simplicity.

BC90 Some preparers of SMEs' financial statements expressed support for recognising actuarial gains and losses directly in equity. That is not method (b). Nor is it what is now permitted by IAS 19 as a result of the amendments to IAS 19 issued in December 2004. Those amendments require the actuarial gains or losses to become part of equity only after they have been recognised in a statement of recognised income and expense. The Board did not favour introducing a new option in the proposed *IFRS for SMEs*—direct recognition in equity bypassing a statement of recognised income and expense.

Share-based payment

BC91 IFRS 2 provides relief for SMEs, and that relief is carried forward in the draft *IFRS for SMEs*. For equity-settled share-based payment transactions with employees, IFRS 2 generally requires measurement by reference to the fair value of the equity instruments granted. However, if the entity is unable to estimate reliably the fair value of the equity instruments granted at the measurement date, IFRS 2 provides for measurement of the equity instruments at their intrinsic value. In developing the draft *IFRS for SMEs*, the Board concluded that IFRS 2 provides appropriate simplifications for SMEs.

Leases

BC92 Paragraph 19.8 requires a lessee to measure rights and obligations under a finance lease at an amount equal to the fair value of the leased property. IAS 17 *Leases* requires an entity in the same circumstances to make two measurements—both the fair value of the leased property and the present value of the minimum lease payments—and to use the lower of the two. Thus Section 19 *Leases* retains the fundamental recognition principle in IAS 17 while simplifying the measurement.

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Transition to the *IFRS for SMEs*

BC93 IFRS 1 *First-time Adoption of International Financial Reporting Standards* requires an entity's first IFRS financial statements to include at least one year of comparative information under IFRSs. Some preparers and auditors of SMEs' financial statements explained to the Board that a requirement to prepare restated prior period data in all cases would be burdensome for SMEs adopting the *IFRS for SMEs* for the first time. Thus, the draft *IFRS for SMEs* proposes an 'impracticability' exemption. Similarly, it provides an impracticability exemption with respect to some requirements for restating the opening balance sheet.

Simplifications considered but not adopted

BC94 In developing the draft *IFRS for SMEs*, the Board considered some recognition and measurement simplifications that it decided not to adopt. Some of those potential simplifications were identified in existing national accounting standards for SMEs. Some were proposed by the Board's constituents in their responses to the Discussion Paper or the recognition and measurement questionnaire in 2005. Those proposals, and the Board's reasons for rejecting them, are described in paragraphs BC95–BC107.

Not to require a cash flow statement

BC95 Some suggested that the Board should not require SMEs to prepare a cash flow statement. Some who held this view believed that preparing a cash flow statement is burdensome. Some contended that users of SMEs' financial statements do not find the cash flow statement useful.

BC96 The Board noted that if a comparative balance sheet (with amounts for the beginning and the end of the reporting period) and an income statement are available, preparing a cash flow statement is not a difficult, time-consuming or costly task. The accounting frameworks of most jurisdictions require broad groups of entities, including SMEs, to prepare a cash flow statement. Moreover, the great majority of lenders and other users of SMEs' financial statements who have communicated with the Board—including particularly lenders and short-term creditors—indicated that the cash flow statement is useful to them.

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Treat all leases as operating leases

BC97 Under IAS 17, a lessee's rights and obligations under a lease are not recognised in the balance sheet if the lease is classified as an operating lease. Although lessees obtain rights and incur obligations under all leases, finance leases create obligations substantially equivalent to those arising when an asset is purchased on credit. Information about such assets and obligations is important for lending and other credit decisions. Lenders consistently say that they do not want 'off balance sheet obligations'.

Treat all employee benefit plans as defined contribution plans

BC98 As with leases, users of financial statements are concerned about 'off balance sheet obligations'. As noted in paragraph BC87, many jurisdictions require SMEs by law to provide benefits that are the equivalent of a defined benefit pension plan—for example, long-service benefits. Users of SMEs' financial statements consistently say that information about the funding status of such obligations is useful and important to them.

Completed contract method for long-term contracts

BC99 The completed contract method can produce a potentially misleading accounting result for a long-term contractor, with some years of large profits and other years of large losses. Many construction contractors are SMEs. The fluctuation between years of large profit and years of large losses may be magnified for SMEs because they tend to have fewer contracts than larger entities. Users of financial statements have told the Board that, for a long-term contractor, the percentage of completion method provides information that they find more useful than the completed contract method.

Fewer provisions

BC100 Provisions are liabilities of uncertain timing or amount. Despite the uncertainties, they are obligations that have met the liability recognition criteria. Users of SMEs' financial statements consistently say they want these obligations recognised in the balance sheet, with the measurement uncertainties explained.

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Non-recognition of share-based payment

BC101 Non-recognition is inconsistent with the definitions of the elements of financial statements, especially an expense. Moreover, users of financial statements generally hold the view that share-based payments to employees should be recognised as remuneration expense because (a) they are intended as remuneration, (b) they involve giving something of value in exchange for services, and (c) the consumption of the employee services received is an expense. However, Section 25 *Share-based Payment* proposes to retain the provisions of IFRS 2 for simplified measurement for SMEs using the intrinsic value method.

Non-recognition of deferred taxes

BC102 Some respondents to the questionnaire and some of those who took part in the public round-table discussions supported the 'taxes payable method' of accounting for income taxes. Under that method, only income taxes currently payable or refundable are recognised; deferred taxes are not recognised. Many users of SMEs' financial statements disagree with the taxes payable method. They point out that deferred taxes are liabilities (or sometimes assets) that can result in large outflows (inflows) of cash in the near future and, therefore, should be recognised. Even those users of financial statements who do not agree that deferred tax liabilities or deferred tax assets should be recognised generally want the amounts, causes and other information disclosed in the notes. Note disclosure would entail the same tracking and computation effort for SMEs as would recognition, but would be inconsistent with the principles for recognising assets and liabilities in the *Framework*. The Board concluded that making a fundamental departure from the recognition principles in IAS 12 *Income Taxes* while requiring disclosure of the information that users of SMEs' financial statements find useful is not justified on a cost-benefit basis. Moreover, the Board believes that deferred taxes satisfy the requirements for recognition as assets and liabilities and can be measured reliably.

Cost model for all agriculture

BC103 Not only is fair value generally regarded as a more relevant measure in this industry, quoted prices are often readily available, markets are active, and measuring cost is actually more burdensome and arbitrary because of the extensive allocations required. Moreover, managers of

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most SMEs that undertake agricultural activities say that they manage on the basis of market prices or other measures of current value rather than historical costs. Users also question the meaningfulness of allocated costs in this industry.

No consolidated financial statements

BC104 In many countries, SMEs are organised into two or more legal entities for tax or other legal reasons, even though they operate as one economic entity. Investors, lenders and other users of SMEs' financial statements say that they find information about the financial position, operating results and cash flows of the economic entity useful for their decisions. They say they cannot use the separate financial statements of the legal entities because those entities often enter into transactions with each other that are not necessarily structured or priced on an arm's length basis. In such circumstances, the amounts reported in the separate statements reflect internal transactions (eg sales between the legal entities) that are not transactions of the economic entity with other economic entities. Also, the entities are often jointly managed, and loans are cross-collateralised. In the Board's judgement, consolidated statements are essential for users when two entities operate as a single economic entity.

Recognition of foreign exchange gains and losses and revaluation increases in profit or loss

BC105 The draft *IFRS for SMEs* proposes that SMEs should recognise items of income or expense directly in equity in only two circumstances:

(a) Paragraph 11.37 provides that SMEs shall recognise changes in the fair value of some hedging instruments directly in equity.

(b) Paragraph 30.13 provides that, in consolidated financial statements, SMEs shall recognise directly in equity a foreign exchange difference (gain or loss) arising on a monetary item that forms part of the reporting entity's net investment in a foreign operation (subsidiary, associate or joint venture).

Additionally, SMEs that choose the revaluation model either for a class of property, plant and equipment (see paragraph 16.13) or for a class of intangible assets (see paragraph 17.23) would credit increases in the asset's carrying amount directly to equity as a revaluation surplus.

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BC106 In developing the draft *IFRS for SMEs*, the Board considered whether to require SMEs to recognise the foreign exchange gains or losses and revaluation increases in profit or loss, rather than directly in equity. This would be consistent with the accounting for actuarial gains and losses on defined benefit plans proposed in Section 27 *Employee Benefits*. It would also be consistent with one of the two approaches proposed in the Exposure Draft of Proposed Amendments to IAS 1—*A Revised Presentation* (published March 2006). Under that approach, all components of income and expense recognised in a period would be presented in a single statement of recognised income and expense. Recognising foreign exchange gains or losses and revaluation increases in profit or loss would also be substantially consistent with the second proposed approach in that Exposure Draft. That approach would present all components of income and expense recognised in a period in two statements but would not permit any components of income and expense (ie non-owner changes in equity) to be presented in the statement of changes in equity. The Board concluded, however, that because the proposed amendments to IAS 1 are not final, the draft *IFRS for SMEs* should not reflect those proposals.

BC107 Because the Board has begun a comprehensive project on financial instruments as part of its convergence efforts with the US Financial Accounting Standards Board, the Board did not consider requiring SMEs to recognise changes in the fair value of all hedging instruments in profit or loss at this time.

All options in IFRSs should be available in the *IFRS for SMEs*. Jurisdictions can remove options

BC108 Full IFRSs include some accounting policy options (choices). Generally, for a given transaction, event or condition, one of the options is simpler to implement than the other(s). The Board considered whether the *IFRS for SMEs* should eliminate all accounting policy options and, therefore, require all SMEs to follow a single accounting policy for a given transaction, event or condition. The benefits of doing so would be simplification of the *IFRS for SMEs* and greater comparability of the resulting financial information among SMEs using the *IFRS for SMEs*. Although the Board found those benefits appealing, it concluded that prohibiting SMEs from using an accounting policy option that is available to entities using full IFRSs could hinder comparability between SMEs and entities applying full IFRSs.

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BC109 The Board recognised that most SMEs are likely to prefer the simpler option in full IFRSs. Therefore, the Board concluded that when full IFRSs allow accounting policy options, the *IFRS for SMEs* should include only the simpler option, and the other (more complex) option(s) should be available to SMEs by cross-reference to the full IFRS. This policy has been implemented in the circumstances described in paragraphs BC110–BC115.

Investment property

BC110 The draft *IFRS for SMEs* provides guidance for the cost-depreciation-impairment model of accounting for investment property. The fair value through profit or loss model would be permitted by cross-reference to IAS 40.

Property, plant and equipment

BC111 The draft *IFRS for SMEs* provides guidance for the cost-depreciation-impairment model of accounting for property, plant and equipment. The revaluation model would be permitted by cross-reference to IAS 16.

Intangible assets

BC112 The draft *IFRS for SMEs* provides guidance for the cost-depreciation-impairment model of accounting for intangible assets. The revaluation model would be permitted by cross-reference to IAS 38.

Borrowing cost

BC113 The draft *IFRS for SMEs* provides guidance for the expense model of accounting for borrowing cost. The capitalisation model would be permitted by cross-reference to IAS 23 *Borrowing Costs*.

Presenting operating cash flows

BC114 The draft *IFRS for SMEs* provides guidance for the indirect method of presenting cash flows from operations. The direct method would be permitted by cross-reference to IAS 7 *Cash Flow Statements*. The direct method is not more difficult for an SME than the indirect method. However, although professional financial analysts generally favour the direct method, the majority of bank lenders and other users of financial

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statements of SMEs expressed a preference for the indirect method for SMEs. They said that the indirect method provides insights into SMEs' accrual accounting. For that reason, the draft *IFRS for SMEs* provides for the indirect method.

Accounting for government grants

BC115 The draft *IFRS for SMEs* provides guidance for one method of accounting for government grants (essentially the model in IAS 41 *Agriculture*). SMEs would be permitted to use the other methods permitted by IAS 20 *Accounting for Government Grants and Disclosure of Government Assistance* by cross-reference to IAS 20.

Optional reversion to full IFRSs by an entity using the *IFRS for SMEs*

BC116 The Board considered whether an entity using the proposed *IFRS for SMEs* should be allowed to choose to apply a recognition or measurement principle permitted in a full IFRS that differs from the principle required by the related section of the draft *IFRS for SMEs*.

BC117 Some proposed that the *IFRS for SMEs* should, in effect, contain 'optional simplifications of IFRSs'. Within this group, there were two schools of thought:

(a) One school would permit SMEs to revert to full IFRSs principle by principle, while otherwise continuing to use the *IFRS for SMEs*.

(b) The second school would permit SMEs to revert to full IFRSs in their entirety, standard by standard but not principle by principle, while otherwise continuing to use the *IFRS for SMEs*. Those who hold this view believe that the recognition and measurement principles in a full IFRS are so interrelated that they should be regarded as an integrated package.

BC118 The alternative view is that an entity should be required to choose only either the complete set of IFRSs or the complete *IFRS for SMEs*. The Board is of that view. Allowing SMEs optionally to revert to full IFRSs either principle by principle or standard by standard, while continuing to follow the IFRS for SMEs for other transactions and circumstances, would result in significant non-comparability. Undesirably, SMEs would have almost an infinite array of combinations of accounting policies from which to choose. As explained in paragraphs BC108–BC115, the draft *IFRS for SMEs* includes some accounting policy options—those that exist in full IFRSs.

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Disclosure simplifications

BC119 The disclosure requirements in the proposed *IFRS for SMEs* are substantially reduced when compared with the disclosure requirements in full IFRSs. The reasons for the reductions are of four principal types:

(a) Some disclosures are not included because they relate to topics covered in IFRSs that are omitted from the draft *IFRS for SMEs* (see paragraphs BC57–BC65).

(b) Some disclosures are not included because they relate to recognition and measurement principles in full IFRSs that have been replaced by simplifications proposed in the draft IFRS (see paragraphs BC70–BC93).

(c) Some disclosures are not included because they relate to options that are not included in the draft *IFRS for SMEs* but are available to SMEs by explicit cross-reference to the full IFRS (see paragraphs BC108–BC115).

(d) Some disclosures are not included on the basis of users' needs or cost-benefit considerations (see paragraphs BC25, BC26 and BC120).

BC120 Assessing disclosures on the basis of users' needs was not easy, because users of financial statements tend to favour more, rather than fewer, disclosures. The Board was guided by the following broad principles:

(a) Users of the financial statements of SMEs are particularly interested in information about short-term cash flows and about obligations, commitments or contingencies, whether or not recognised as liabilities. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.

(b) Users of the financial statements of SMEs are particularly interested in information about liquidity and solvency. Disclosures in full IFRSs that provide this sort of information are necessary for SMEs as well.

(c) Information on measurement uncertainties is important for SMEs.

(d) Information about an entity's accounting policy choices is important for SMEs.

(e) Disaggregations of amounts reported on the face of SMEs' financial statements are important for an understanding of those statements.

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(f) Some disclosures in full IFRSs are more relevant to investment decisions in public capital markets than to the transactions and other events and conditions encountered by typical SMEs with around 50 employees.

Why a separate volume rather than added sections in each IFRS

BC121 The Board saw merit in two approaches—publishing the *IFRS for SMEs* in a separate volume and publishing a separate section in each individual IFRS (including Interpretations). The principal advantages of the separate volume are:

(a) ease of use for those seeking to apply the *IFRS for SMEs*. If the *IFRS for SMEs* addresses the transactions, events and conditions typically encountered by SMEs with around 50 employees, much of the material in full IFRSs would not normally have application for SMEs.

(b) the *IFRS for SMEs* can be drafted in a simplified language without the details that are needed in full IFRSs.

BC122 The advantages of including the requirements for SMEs as a separate section of each IFRS (including Interpretations) include:

(a) the modifications or exemptions are highlighted.

(b) to the extent that SMEs must look to full IFRSs, putting both the requirements for SMEs and the related full standards in one place is more user-friendly.

(c) it would reduce the likelihood that, in drafting IASB standards for SMEs, an unintended difference will arise between an IFRS and the related requirements in the *IFRS for SMEs*.

BC123 Respondents to the Discussion Paper generally favoured the separate volume approach. On balance the Board agreed for the reasons outlined in paragraph BC121.

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Why organisation by topic

BC124 The Board saw merit both in numbering the requirements for SMEs similarly to full IFRSs and in topical organisation. Using the same numbering system as full IFRSs would enable a user to link back to the full IFRS to seek further guidance on an accounting question. Topical organisation, on the other hand, would make the IFRS for SMEs more like a reference manual, which is likely to be the way that people would use it, and thus it would be more user-friendly. Indexing could minimise the benefits of one of those approaches over the other. Providing the IFRS for SMEs in electronic form could also minimise the benefits of one approach over the other. Most respondents to the Discussion Paper favoured organisation by topic. On balance the Board found the benefits of a topically organised reference manual persuasive.

The Board's plan for maintaining (updating) the *IFRS for SMEs*

BC125 In the Discussion Paper, the Board expressed a tentative view that, 'once the initial set of IASB Standards for SMEs is in place, concurrently with each exposure draft of an IFRS and each draft Interpretation, and most likely as part of those documents, the Board will propose the related IASB Standard or Interpretation for SMEs. The effective dates of the new or revised IASB Standards for SMEs would probably be the same as the effective date of the new or revised IFRSs (including Interpretations).' In general, respondents to the Discussion Paper did not agree with this approach. They explained that because SMEs do not have internal accounting resources or the ability to hire accounting advisers on an ongoing basis, the IFRS for SMEs should be updated only periodically, perhaps only once each two or three years. They also noted that not every new IFRS or Interpretation or amendment to an IFRS (including Interpretations) will affect the IFRS for SMEs. On the basis of users' needs or cost-benefit considerations, some of those changes may be relevant only for full IFRSs. Furthermore, there may be some changes to the IFRS for SMEs that are appropriate even if full IFRSs are not changed.

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BC126 The principal benefits of considering changes to the IFRS for SMEs at the same time as each new IFRS is proposed or each amendment to an existing IFRS is proposed are consistency of consideration both by the Board and respondents, avoiding a time lag between when changes affect full IFRSs and when similar changes affect the IFRS for SMEs, and avoiding potentially differing standards in full IFRSs and the IFRS for SMEs.

BC127 On balance, the Board found the arguments set out in paragraph BC125 for periodic, rather than contemporaneous, updating of the IFRS for SMEs generally persuasive. However, the Board also concluded that there might be matters for which amendment of the IFRS for SMEs will be necessary more frequently than once in several years. Paragraph 16 of the Preface to the draft *IFRS for SMEs* explains the Board's plan for maintaining the *IFRS for SMEs*.

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Alternative view on the proposed *International Financial Reporting Standard for Small and Medium-sized Entities*

AV1 One Board member voted against the publication of the Exposure Draft of the proposed *International Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)*. That Board member's alternative view is set out below.

AV2 The Board member believes that the proposed *IFRS for SMEs* is neither necessary nor desirable. It is unnecessary because the vast majority of accounting policy decisions of an SME are straightforward and extensive reference to IFRSs will not be required and, when required, not burdensome.

AV3 It is undesirable because the proposed IFRS would produce non-comparable information. SMEs will not be comparable with each other and will not be comparable with publicly accountable entities. That result is inconsistent with the IASB *Framework* and the Concepts and Pervasive Principles of the proposed IFRS.

AV4 Non-comparability will result because the proposed IFRS would allow SMEs, as a result of paragraph 10.3, to ignore the requirements of other IFRSs even when the specific accounting issue is addressed in those IFRSs. If an entity is satisfied with the result of applying paragraph 10.3(a) and (b) there is never a requirement to look to full IFRSs. Thus, identical transactions can be accounted for differently by different SMEs and differently from publicly accountable entities. If the Board finds it necessary to develop educational materials to assist SMEs in applying IFRSs, that would certainly be appropriate. However, this Board member believes that in all circumstances IFRSs should ultimately be the source of accounting guidance for all entities.

AV5 This Board member does not believe that the Board has demonstrated the need to make modifications to recognition and measurement requirements in IFRSs for application by SMEs on the basis of either cost-benefit analysis or user needs. Alternatively, the Board member would much more extensively modify the disclosure requirements to meet special user needs. That modification might well create disclosures not required at present, such as information about economic dependency, although many of the presentation and disclosure requirements proposed in the Exposure Draft seem unnecessary.

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AV6 This Board member also believes that the Exposure Draft is inconsistent with the Constitution of the International Accounting Standards Committee Foundation and the *Preface to International Financial Reporting Standards*. Those documents set out an objective of a single set of accounting standards taking account of the special needs of small and medium-sized entities and emerging economies. The Board member accepts that objective but does not believe it implies separate sets of standards for entities in differing circumstances as indicated in paragraph BC21. The conclusion of that paragraph suggests that many sets of accounting standards would be appropriate depending on different circumstances.

DRAFT IMPLEMENTATION GUIDANCE

Illustrative Financial Statements and Disclosure Checklist

Exposure Draft

INTERNATIONAL FINANCIAL REPORTING STANDARD FOR SMALL AND MEDIUM-SIZED ENTITIES

Comments to be received by 1 October 2007

This draft Implementation Guidance accompanies the Exposure Draft of the proposed *International Financial Reporting Standard for Small and Medium-sized Entities* (see separate booklet). Comments on the draft standard and its accompanying documents should be sent in writing so as to be received by **1 October 2007**. Respondents are asked to send their comments electronically to the IASB Website (www.iasb.org), using the 'Open to Comment' page.

All responses will be put on the public record unless the respondent requests confidentiality. However, such requests will not normally be granted unless supported by good reason, such as commercial confidence.

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[Draft] Implementation Guidance

This [draft] guidance accompanies, but is not part of, the International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs).

Illustrative Financial Statements

F1 Section 3 *Financial Statement Presentation* of the [draft] *IFRS for SMEs* defines a complete set of financial statements and prescribes general standards of financial statement presentation. Sections 4–8 prescribe the format and content of the individual financial statements and notes. Other sections of the [draft] *IFRS for SMEs* establish additional presentation and disclosure requirements. The financial statements set out below illustrate how those presentation and disclosure requirements might be met by a typical small or medium-sized entity. Of course, each entity will need to consider the content, sequencing and format of presentation and the descriptions used for line items to achieve a fair presentation in that entity's particular circumstances.

F2 The illustrative balance sheet presents current assets followed by non-current assets, and presents current liabilities followed by non-current liabilities and then by equity. This is one way in which a balance sheet distinguishing between current and non-current items may be presented. Other formats may be equally appropriate, provided the distinction is clear. Consistently with paragraph 3.19 of the [draft] *IFRS for SMEs*, an entity may use titles for the financial statements other than those used in these illustrations.

F3 Two statements of income and retained earnings are provided to illustrate the alternative classifications of income and expenses, by nature and by function—see paragraph 5.9 of the [draft] *IFRS for SMEs*.

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F4 The examples are not intended to illustrate all aspects of the [draft] *IFRS for SMEs*.

XYZ Group

Consolidated statement of income and retained earnings for the year ended 31 December 20X2

(Alternative 1 – illustrating the classification of expenses by function)

	Notes	20X2	20X1
		CU	CU
Revenue	5	6,863,545	5,808,653
Cost of sales		(5,178,530)	(4,422,575)
Gross profit		1,685,015	1,386,078
Other income		88,850	25,000
Distribution costs		(175,550)	(156,800)
Administrative expenses		(810,229)	(660,389)
Other expenses		(105,763)	(100,030)
Finance costs	6	(26,366)	(36,712)
Profit before tax	7	655,957	457,147
Income tax expense	8	(270,651)	(189,559)
Profit for the period		385,306	267,588
Retained earnings at start of year		2,171,352	2,003,764
Dividends (per share 20X2 5.00, 20X1 3.33)		(150,000)	(100,000)
Retained earnings at end of year		2,406,658	2,171,352

Note: The format illustrated above aggregates expenses according to their function (cost of sales, distribution, administrative etc). As the only changes to XYZ Group's equity during the year arose from profit or loss and payment of dividends, it has elected to present a combined statement of income and retained earnings instead of separate income and equity statements.

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XYZ Group

Consolidated statement of income and retained earnings for the year ended 31 December 20X2

(Alternative 2 – illustrating the classification of expenses by nature)

	Notes	20X2	20X1
		CU	CU
Revenue	5	6,863,545	5,808,653
Other income		88,850	25,000
Changes in inventories of finished goods and work in progress		3,310	(1,360)
Raw material and consumables used		(4,786,699)	(4,092,185)
Employee salaries and benefits		(936,142)	(879,900)
Depreciation and amortisation expense		(272,060)	(221,247)
Impairment of property, plant and equipment		(30,000)	—
Other expenses		(248,481)	(145,102)
Finance costs	6	(26,366)	(36,712)
Profit before tax	7	655,957	457,147
Income tax expense	8	(270,651)	(189,559)
Profit for the year		385,306	267,588
Retained earnings at start of year		2,171,352	2,003,764
Dividends (per share 20X2 5.00, 20X1 3.33)		(150,000)	(100,000)
Retained earnings at end of year		2,406,658	2,171,352

Note: The format illustrated above aggregates expenses according to their nature (raw materials and consumables, employee benefits, depreciation and amortisation, impairment etc). As the only changes to XYZ Group's equity during the year arose from profit or loss and payment of dividends, it has elected to present a combined statement of income and retained earnings instead of separate income and equity statements.

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XYZ Group

Consolidated balance sheet at 31 December 20X2

	Notes	20X2	20X1
ASSETS		**CU**	**CU**
Current assets			
Cash		26,700	20,875
Trade and other receivables	**14**	585,548	573,862
Inventories	**13**	57,250	47,920
		669,498	642,657
Non-current assets			
Investment in associate	**11**	107,500	107,500
Property, plant and equipment	**9**	2,548,473	2,401,455
Intangible assets	**10**	850	2,550
Deferred tax assets	**12**	3,909	2,912
		2,660,732	2,514,417
Assets held for sale	**15**	1,603	—
Total assets		3,331,833	3,157,074
LIABILITIES AND EQUITY			
Current liabilities			
Bank overdrafts	**17**	83,600	115,508
Trade payables		433,130	425,560
Current tax liabilities		271,648	190,316
Current portion of employee benefit obligations	**18**	6,181	5,943
Current portion of obligations under finance leases	**19**	21,461	19,884
		816,020	757,211
Non-current liabilities			
Bank loans	**17**	50,000	150,000
Long-term employee benefit obligations	**18**	4,442	3,887
Obligations under finance leases	**19**	23,163	44,624
		77,605	198,511

continued...

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...continued

	Notes	20X2	20X1
		CU	CU
Liabilities directly associated with assets classified as held for sale	**15**	1,550	—
Total liabilities		895,175	955,722
Equity			
Share capital	**16**	30,000	30,000
Retained earnings	**4**	2,406,658	2,171,352
		2,436,658	2,201,352
Total liabilities and equity		3,331,833	3,157,074

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XYZ Group

Consolidated cash flow statement for the year ended 31 December 20X2

	Notes	20X2	20X1
		CU	CU
Cash flows from operating activities			
Profit for the year		385,306	267,588
Adjustments for:			
Finance costs		26,366	36,712
Income tax expense		270,651	189,559
Depreciation of property, plant and equipment		270,360	219,547
Impairment loss		30,000	—
Amortisation of intangibles		1,700	1,700
Gain on disposal of property, plant and equipment		(63,850)	—
Decrease (increase) in trade and other receivables		(11,686)	(52,628)
Decrease (increase) in inventories (20X2 includes CU131 of production supplies reclassified as assets held for sale)		(9,461)	(2,870)
Increase (decrease) in trade payables (20X2 includes CU1,550 reclassified as liabilities directly associated with assets classified as held for sale)		9,120	10,870
Increase in current and long-term employee benefits payable		793	193
Cash generated from operations		909,299	670,671
Interest paid		(26,366)	(36,712)
Income taxes		(190,316)	(172,426)
Net cash from operating activities		692,617	461,533
Cash flows from investing activities			
Proceeds from sale of equipment		100,000	—
Purchases of equipment		(485,000)	(435,000)
Net cash used in investing activities		(385,000)	(435,000)

continued...

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...continued

	Notes	20X2	20X1
		CU	CU
Cash flows from financing activities			
Payment of finance lease liabilities		(19,884)	(18,423)
Repayment of borrowings		(100,000)	—
Dividends paid		(150,000)	(100,000)
Net cash used in financing activities		(269,884)	(118,423)
Net increase (decrease) in cash and cash equivalents		37,733	(91,890)
Cash and cash equivalents at beginning of year		(94,633)	(2,743)
Cash and cash equivalents at end of year	**20**	(56,900)	(94,633)

Note: The format above illustrates the indirect method of reporting cash flows from operating activities.

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XYZ Group

Accounting policies and explanatory notes to the financial statements for the year ended 31 December 20X2

1. General information

XYZ (Holdings) Limited (the Company) is a limited company incorporated in A Land. The address of its registered office and principal place of business is _________. XYZ Group consists of the Company and its wholly-owned subsidiary XYZ (Trading) Limited. Their principal activities are the manufacture and sale of candles.

2. Basis of preparation and accounting policies

These consolidated financial statements have been prepared in accordance with the [draft] *International Financial Reporting Standard for Small and Medium-sized Entities (IFRS for SMEs)* issued by the International Accounting Standards Board (IASB). They are presented in the currency units (CU) of A Land.

Basis of consolidation

The consolidated financial statements incorporate the financial statements of the Company and its wholly-owned subsidiary. All intragroup transactions, balances, income and expenses are eliminated.

Investments in associates

Investments in associates are accounted for at cost less any accumulated impairment losses.

Dividend income from investments in associates is recognised when the shareholders' rights to receive payment have been established and is shown as other income.

Non-current assets held for sale

Non-current assets (and disposal groups) classified as held for sale are measured at the lower of the assets' previous carrying amount and fair value less costs to sell.

Revenue recognition

Revenue is measured at the fair value of the consideration received or receivable, net of discounts and sales-related taxes. Revenue from sales of goods is recognised when the goods are delivered and title has passed. Royalty revenue from licensing candle-making patents for use by others is recognised over the licence period.

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Borrowing costs

All borrowing costs are recognised in profit or loss in the period in which they are incurred.

Income taxes

Income tax expense represents the sum of the tax currently payable and deferred tax.

The tax currently payable is based on taxable profit for the year.

Deferred tax is recognised on differences between the carrying amounts of assets and liabilities in the financial statements and their corresponding tax bases (temporary differences). Deferred tax liabilities are recognised for all taxable temporary differences. Deferred tax assets are recognised to the extent that it is probable that taxable profits will be available against which deductible temporary differences can be utilised.

The carrying amount of deferred tax assets is reviewed at each balance sheet date and reduced to the extent that it is no longer probable that sufficient taxable profits will be available to allow all or part of the asset to be recovered.

Deferred tax is calculated at the tax rates that are expected to apply in the period when the liability is settled or the asset is realised, based on tax rates that have been enacted or substantively enacted by the end of the reporting period.

Property, plant and equipment

Items of property plant and equipment are measured at cost less accumulated depreciation and any accumulated impairment losses.

Depreciation is charged so as to allocate the cost of assets less their residual values over their estimated useful lives, using the straight-line method. The following rates are used for the depreciation of property, plant and equipment:

Buildings	2%
Fixtures and equipment	10% to 30%

Intangible assets

Intangible assets are purchased computer software that is stated at cost less accumulated depreciation and any accumulated impairment losses. It is amortised over its estimated life of five years using the straight-line method.

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Impairment of non-current assets

At each balance sheet date, the carrying amounts of tangible and intangible assets and investments in associates are reviewed to determine whether there is any indication that those assets have suffered an impairment loss. If the fair value less costs to sell of an asset (or group of assets) is estimated to be less than its carrying amount, the carrying amount of the asset (or group of assets) is reduced to its fair value less costs to sell. An impairment loss is recognised immediately in profit or loss.

If an impairment loss subsequently reverses, the carrying amount of the asset (or group of assets) is increased to the revised estimate of its fair value less costs to sell, but not in excess of the amount that would have been determined had no impairment loss been recognised for the asset (group of assets) in prior years. A reversal of an impairment loss is recognised immediately in profit or loss.

Leases

Leases are classified as finance leases whenever the terms of the lease transfer substantially all the risks and rewards of ownership to the lessee. All other leases are classified as operating leases.

Assets held under finance leases are recognised as assets of the Group at their fair value at the inception of the lease. The corresponding liability to the lessor is included in the balance sheet as a finance lease obligation. Lease payments are apportioned between finance charges and reduction of the lease obligation so as to achieve a constant rate of interest on the remaining balance of the liability. Finance charges are charged directly to profit or loss. Assets held under finance leases are included in property, plant and equipment, and depreciation and impairment losses are recognised.

Rentals payable under operating leases are charged to profit or loss on a straight-line basis over the term of the relevant lease.

Inventories

Inventories are stated at the lower of cost and selling price less costs to complete and sell. Cost is calculated using the first-in, first-out (FIFO) method.

Trade and other receivables

Trade and other receivables are measured at amortised cost using the effective interest method. At the end of each reporting period, the carrying amounts of trade and other receivables are reviewed to determine whether there is any objective evidence that the amounts are not recoverable. If so, an impairment loss is recognised immediately in profit or loss.

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3. Key sources of estimation uncertainty

Long-service payment

In determining the liability for other long-term benefits (explained in note 18), management must make an estimate of salary increases over the following five years, the discount rate for the next five years to use in the present value calculation and the number of employees expected to leave before they receive the benefits. Note 18 provides details of the carrying amount of the obligation at the year-end.

4. Restriction on payment of dividend

Under the terms of the bank loan and bank overdraft agreements, dividends cannot be paid to the extent that they would reduce the balance of retained earnings below the sum of the outstanding balance of the bank loan and the bank overdraft.

5. Revenue

An analysis of the Group's revenue is as follows:

	20X2	20X1
	CU	CU
Sale of goods	6,743,545	5,688,653
Royalties – licensing of candle-making patents	120,000	120,000
	6,863,545	5,808,653

6. Finance costs

	20X2	20X1
	CU	CU
Interest on bank loan and overdraft	(21,250)	(30,135)
Interest on finance leases	(5,116)	(6,577)
	(26,366)	(36,712)

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7. Profit before tax

The following items have been recognised as expenses (income) in determining profit before tax:

	20X2	20X1
	CU	CU
Gain on disposal of property, plant and equipment	(63,850)	—
Depreciation of property, plant and equipment	270,360	219,547
Impairment of property, plant and equipment (included in impairment of property, plant and equipment/administrative expenses)	30,000	
Amortisation of software (included in depreciation and amortisation/administrative expenses)	1,700	1,700
Employee benefits expense	936,142	879,900
Cost of inventories recognised as expense	4,783,389	4,093,545

8. Income tax expense

	20X2	20X1
	CU	CU
Current tax	271,648	190,316
Deferred tax (note 12)	(997)	(757)
	270,651	189,559

Domestic income tax is calculated at 40% (20X1: 40%) of the estimated assessable profit for the year.

The total income tax expense for the year can be reconciled to the accounting profit as follows:

	20X2	20X1
	CU	CU
Profit before tax	655,957	457,147
Tax at domestic rate of 40%	262,383	182,859
Tax effect of certain employee compensation expenses (CU20,670 in 20X2 and CU16,750 in 20X1) recognised in measuring profit before tax that are not tax-deductible	8,268	6,700
Tax expense for the year	270,651	189,559

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9. Property, plant and equipment

	Land and buildings	Fixtures and equipment	Total
	CU	CU	CU
Cost			
1 January 20X1	1,960,000	907,045	2,867,045
Additions	—	435,000	435,000
Disposals	—	(240,000)	(240,000)
At 31 December 20X1	1,960,000	1,102,045	3,062,045
Additions	—	485,000	485,000
Disposals	—	(241,000)	(241,000)
Reclassified as held for sale (note 15)		(1,550)	(1,550)
At 31 December 20X2	1,960,000	1,344,495	3,304,495
Accumulated depreciation and impairment			
1 January 20X1	360,000	321,043	681,043
Annual depreciation	30,000	189,547	219,547
Less accumulated depreciation on assets disposed of		(240,000)	(240,000)
At 31 December 20X1	390,000	270,590	660,590
Annual depreciation	30,000	240,360	270,360
Impairment	—	30,000	30,000
Less accumulated depreciation on assets disposed of	—	(204,850)	(204,850)
Less accumulated depreciation on assets reclassified as held for sale (note 15)		(78)	(78)
At 31 December 20X2	420,000	336,022	756,022
Carrying amount			
31 December 20X1	1,570,000	831,455	2,401,455
31 December 20X2	1,540,000	1,008,473	2,548,473

During the period, the Group noticed a significant decline in the efficiency of two of its vehicles and so carried out a review of their fair values less costs to sell. The review led to the recognition of an impairment loss of CU30,000.

The carrying amount of the Group's fixtures and equipment includes an amount of CU40,000 (20X1: CU60,000) in respect of assets held under finance leases.

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10. Intangible assets

Software:

Cost	**CU**
1 January 20X1	8,500
Additions	—
Disposals	—
At 31 December 20X1	8,500
Additions	—
Disposals	—
At 31 December 20X2	8,500
Accumulated depreciation and impairment	
1 January 20X1	4,250
Annual amortisation	1,700
At 31 December 20X1	5,950
Annual amortisation	1,700
At 31 December 20X2	7,650
Carrying amount	
31 December 20X1	2,550
31 December 20X2	850

11. Investment in associate

	20X2	**20X1**
	CU	**CU**
Cost of investment in associate	107,500	107,500

The Group owns 35 per cent of an associate whose shares are not publicly traded. Summarised financial information of the associate is set out below:

	20X2	**20X1**
	CU	**CU**
Total assets	559,509	589,423
Total liabilities	(167,128)	(156,312)
Net assets	392,381	433,111

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	20X2	20X1
	CU	CU
Revenue	518,887	528,536
Profit for the year	111,137	118,534

12. Deferred tax

Differences between amounts recognised in the income statement and amounts reported to tax authorities in connection with investments in the subsidiary and associate are insignificant.

The deferred tax asset is the tax effect of an expected future income tax benefit relating to the long-service benefit (note 18) that will not be tax-deductible until the benefit is actually paid but has already been recognised as an expense in measuring the Group's profit for the year. The Group has recognised the full related deferred tax asset because, on the basis of past years and future expectations, management considers it probable that taxable profits will be available against which the future income tax deduction can be utilised.

The following are the deferred tax liabilities (assets) recognised by the Group during the current and prior years:

	Software	Long-service benefit	Total
	CU	CU	CU
At 1 January 20X1	1,700	(3,855)	(2,155)
Charge (credit) to profit or loss for the year	(680)	(77)	(757)
At 1 January 20X2	1,020	(3,932)	(2,912)
Charge (credit) to profit or loss for the year	(680)	(317)	(997)
At 31 December 20X2	340	(4,249)	(3,909)

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The deferred tax asset for long-service benefits and the deferred tax liability for software relate to income taxes in the same jurisdiction, and the law allows net settlement. Therefore, they have been offset in the balance sheet as follows:

	20X2	20X1
	CU	CU
Deferred tax liability	340	1,020
Deferred tax asset	(4,249)	(3,932)
	(3,909)	(2,912)

13. Inventories

	20X2	20X1
	CU	CU
Raw materials	42,470	36,450
Work in progress	1,140	900
Finished goods	13,640	10,570
	57,250	47,920
Production supplies classified as part of a disposal group held for sale (note 15)	131	—
	57,381	47,920

14. Trade and other receivables

	20X2	20X1
	CU	CU
Trade debtors	528,788	528,384
Prepayments	56,760	45,478
	585,548	573,862

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15. Assets held for sale

On 10 December 20X2, the directors resolved to dispose of one of the Group's recently acquired rolling machines for beeswax candles. Negotiations with several interested parties have taken place. The machine, along with related supplies purchased for use with the machine and the liability to the supplier of the machine, is expected to be sold within twelve months and so has been classified as a disposal group held for sale and presented separately in the balance sheet.

The proceeds of disposal are expected to exceed the net carrying amount of the relevant assets and liabilities and, accordingly, no impairment loss has been recognised on the assets classified as held for sale.

The major classes of assets and liabilities in the disposal group classified as held for sale are as follows:

	20X2
	CU
Property, plant and equipment	1,472
Production supplies	131
	1,603
Payable associated with assets classified as held for sale	(1,550)
	53

16. Share capital

Balances as at 31 December 20X1 and 20X2 of CU30,000 comprise 30,000 ordinary shares with par value CU1.00 fully paid, issued and outstanding. An additional 70,000 shares are legally authorised but unissued.

17. Bank overdrafts and loans

	20X2	20X1
	CU	CU
Bank overdrafts	83,600	115,508
Bank loans—fully repayable in 20X4, prepayable without penalty	50,000	150,000
	133,600	265,508

The bank overdraft and loan are secured by a floating lien over the Group's assets.

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18. Long-service benefit

The liability for employee benefit obligations relates to government mandated long-service payments. All full-time members of staff, excluding directors, are covered by the programme. A payment is made of 5 per cent of salary (as determined for the twelve months before the payment) at the end of each of five years of employment. The payment is made as part of the December payroll in the fifth year. The Group does not fund this obligation in advance.

The accrual to be recognised at the year-end is determined on the basis of a present value calculation assuming a 3 per cent average annual salary increase, with employee turnover based on the Group's recent experience, discounted using the current market yield for high quality corporate bonds.

	CU
At 1 January 20X2	9,830
Additional accrual during year	7,033
Payment made in year	(6,240)
At 31 December 20X2	10,623

Analysed as:

	20X2	20X1
	CU	CU
Current liability	6,181	5,943
Non-current liability	4,442	3,887
Total	10,623	9,830

19. Obligations under finance leases

The Group holds one piece of specialised machinery with an estimated useful life of five years under a five-year finance lease. The future minimum lease payments at the end of the year, for each future year, are as follows:

	20X2	20X1
	CU	CU
In 20X2	n/a	25,000
In 20X3	25,000	25,000
In 20X4	25,000	25,000
	50,000	75,000

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The obligation is analysed as:

	20X2	20X1
Current	CU	CU
Non-current	21,461	19,884
	23,163	44,624
	44,624	64,508

20. Cash and cash equivalents

	20X2	20X1
	CU	CU
Cash on hand	26,700	20,875
Overdrafts	(83,600)	(115,508)
	(56,900)	(94,633)

21. Obligations under operating leases

	20X2	20X1
	CU	CU
Minimum lease payments under operating leases recognised as an expense during the year	26,100	26,100

At the balance sheet date, the Group has outstanding commitments under non-cancellable operating leases that fall due as follows:

	20X2	20X1
	CU	CU
In 20X2	n/a	26,100
In 20X3	13,050	13,050

Operating lease payments represent rentals payable by the Group for certain items of equipment. Leases are negotiated for an average period of three years, with fixed rentals over the same period.

22. Contingent liabilities

During 20X2, a customer of the Group instigated proceedings against XYZ (Trading) Limited for a fire caused by a faulty candle. The customer asserts that its total losses are CU50,000 and has claimed this amount from the company.

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The Group's lawyers do not consider that the claim has merit, and they have recommended that it be contested. No provision has been recognised in these financial statements as the Group's management does not consider it probable that a loss will arise.

23. Event after the balance sheet date

On 25 January 20X3, there was a flood in one of the candle storage rooms. The cost of refurbishment is expected to be CU36,000. The reimbursements from insurance are estimated to be CU16,000.

24. Related party transactions

Transactions between the Company and its subsidiary, which is a related party, have been eliminated in consolidation.

The Group sells goods to its associate (see note 11), which is a related party, as follows:

	Sales of goods		Amounts owed to the Group by the related party at year-end	
	20X2	**20X1**	**20X2**	**20X1**
	CU	**CU**	**CU**	**CU**
Associate	10,000	8,000	800	400

The payments under the finance lease (see note 19) are personally guaranteed by a principal shareholder of the Company. No charge has been requested for this guarantee.

The remuneration of directors and other members of key management during the year was as follows:

	20X2	**20X1**
	CU	**CU**
Salaries	190,500	169,300
Other short-term benefits	15,213	9,200
Post-employment benefits	44,205	29,760

25. Approval of financial statements

These financial statements were approved by the board of directors and authorised for issue on 10 March 20X3.

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Disclosure checklist

This disclosure checklist has been derived from the disclosure requirements in the [draft] IFRS for SMEs*.*

D1 This disclosure checklist summarises the disclosures that are required throughout the [draft] *IFRS for SMEs*. In most cases, the [draft] *IFRS for SMEs* does not specify whether the disclosure should be made in the notes or on the face of the financial statements. In several cases, however, disclosures are expressly required to be on face of financial statements; these are identified in this checklist.

D2 This checklist deals with disclosures. While it does not deal with presentation format, often a required presentation is the equivalent of a disclosure requirement. To illustrate, Sections 3–6 of the [draft] *IFRS for SMEs* require the presentation of some specific line items on the face of the balance sheet, income statement, statement of changes in equity and cash flow statement. Those presentation requirements are essentially disclosure requirements and are included in this checklist.

D3 The disclosure requirements in the [draft] *IFRS for SMEs* should be regarded as minimum requirements. An entity must present additional line items, headings and subtotals on the face of the financial statements when such presentation is relevant to an understanding of the entity's financial position, performance, and changes in financial position. Similarly, an entity must include in the notes to financial statements information that is not presented on the face of the financial statements but is relevant to an understanding of them.

D4 Under the [draft] *IFRS for SMEs*, an entity is required or permitted to apply an International Financial Reporting Standard (IFRS) in the following cases:

(a) The entity elects to apply an accounting policy option that is included in the [draft] *IFRS for SMEs* by cross-reference to an IFRS. Examples include the direct method of preparing the cash flow statement; accounting for financial instruments under IAS 39 *Financial Instruments: Recognition and Measurement* rather than under the provisions of Section 11; the equity method of accounting for investments in associates and joint ventures; the proportionate consolidation method of accounting for investments in joint ventures; the fair value through profit or loss model for investment property; the revaluation model for property, plant and equipment

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and for intangible assets; capitalisation of development costs; and capitalisation of borrowing costs.

(b) The entity is required or permitted to apply an IFRS because the [draft] *IFRS for SMEs* does not address specific events, transactions or circumstances that are covered in IFRSs. That may be the case either because:

  (i) the [draft] *IFRS for SMEs* states that if an SME does encounter such events, transactions or circumstances it should apply the provisions of the relevant IFRS. Examples include calculation of the recoverable amount of goodwill; equity-settled share-based payment; financial reporting in a hyperinflationary economy; specialised industry accounting (extractive industries and agriculture); and interim reporting.

  (ii) paragraph 10.4 of the [draft] *IFRS for SMEs* permits the entity to apply the requirements and guidance in IFRSs and Interpretations of IFRSs dealing with similar and related issues.

(c) The entity elects to follow IAS 39 rather than Section 11 in accounting for financial assets and financial liabilities.

An entity that applies an IFRS in the foregoing circumstances is required to make the relevant disclosures as required by that IFRS. This disclosure checklist does not include those potential disclosures.

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Disclosure requirements in the [draft] *IFRS for SMEs* section by section

Section 1 Scope

No disclosures required by this section.

Section 2 Concepts and Pervasive Principles

No disclosures required by this section.

Section 3 Financial Statement Presentation

Compliance with the [draft] *IFRS for SMEs*

Paragraph	
3.2	An entity whose financial statements comply with the *IFRS for SMEs* shall make an explicit and unreserved statement of such compliance in the notes.
3.4	When an entity departs from a requirement of this [draft] standard in accordance with paragraph 3.3, it shall disclose: (a) that management has concluded that the financial statements present fairly the entity's financial position, financial performance and cash flows; (b) that it has complied with the *IFRS for SMEs*, except that it has departed from a particular requirement to achieve a fair presentation; (c) the nature of the departure, including the treatment that the *IFRS for SMEs* would require, the reason why that treatment would be so misleading in the circumstances that it would conflict with the objective of financial statements set out in Section 2, and the treatment adopted; and (d) for each period presented, the financial effect of the departure on each item in the financial statements that would have been reported in complying with the requirement.

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3.5	When an entity has departed from a requirement of this [draft] standard in a prior period, and that departure affects the amounts recognised in the financial statements for the current period, it shall make the disclosures set out in paragraph 3.4(c) and (d).
3.6	In the extremely rare circumstances in which management concludes that compliance with a requirement in this [draft] standard would be so misleading that it would conflict with the objective of financial statements of SMEs set out in Section 2, but the relevant regulatory framework prohibits departure from the requirement, the entity shall, to the maximum extent possible, reduce the perceived misleading aspects of compliance by disclosing: (a) the nature of the requirement in this [draft] standard, and the reason why management has concluded that complying with that requirement is so misleading in the circumstances that it conflicts with the objective of financial statements set out in Section 2; and (b) for each period presented, the adjustments to each item in the financial statements that management has concluded would be necessary to achieve a fair presentation.
3.7	When an entity does not prepare financial statements on a going concern basis, it shall disclose that fact, together with the basis on which it prepared the financial statements and the reason why the entity is not regarded as a going concern.

Reclassifications

3.10	When the presentation or classification of items in the financial statements is changed, an entity shall reclassify comparative amounts unless the reclassification is impracticable. When comparative amounts are reclassified, an entity shall disclose: (a) the nature of the reclassification; (b) the amount of each item or class of items that is reclassified; and (c) the reason for the reclassification.
3.11	When it is impracticable to reclassify comparative amounts, an entity shall disclose: (a) the reason for not reclassifying the amounts; and (b) the nature of the adjustments that would have been made if the amounts had been reclassified.

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Comparative information

3.12	Except when this [draft] standard permits or requires otherwise, an entity shall disclose comparative information in respect of the previous comparable period for all amounts reported in the financial statements (including the information on the face of the financial statements and in the notes). An entity shall include comparative information for narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.

Identification of the financial statements

3.20	Disclose: (a) the name of the reporting entity and any change in its name since the end of the preceding reporting period; (b) whether the financial statements cover the individual entity or a group of entities; (c) the date of the end of the reporting period and the period covered by the financial statements; (d) the presentation currency, as defined in Section 31; and (e) the level of rounding, if any, used in presenting amounts in the financial statements.

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Section 4 Balance Sheet

Information to be presented on the face of the balance sheet

4.2	As a minimum, an entity shall include, on the face of the balance sheet, line items that present the following amounts: (a) cash and cash equivalents; (b) trade and other receivables; (c) financial assets (excluding amounts shown under (a), (b) and (h)); (d) inventories; (e) property, plant and equipment; (f) intangible assets; (g) biological assets; (h) investments accounted for using the equity method; (i) the total of non-current assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with Section 36; (j) trade and other payables; (k) financial liabilities (excluding amounts shown under (j) and (o); (l) liabilities and assets for current tax; (m) deferred tax liabilities and deferred tax assets (these shall always be classified as non-current); (n) liabilities included in disposal groups classified as held for sale. (o) provisions; (p) minority interest, presented within equity separately from the parent shareholders' equity; and (q) equity attributable to shareholders of the parent.

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Current/non-current distinction

4.5	An entity shall present current and non-current assets, and current and non-current liabilities, as separate classifications on the face of its balance sheet in accordance with paragraphs 4.6–4.9, except when a presentation based on liquidity provides information that is reliable and more relevant. When that exception applies, all assets and liabilities shall be presented in order of approximate liquidity.

Information to be presented either on the face of the balance sheet or in the notes

4.12	An entity shall disclose, either on the face of the balance sheet or in the notes, the following subclassifications of the line items presented: (a) classes of items of property, plant and equipment in accordance with Section 16; (b) amounts receivable from trade customers, receivables from related parties, prepayments and other amounts; (c) classes of inventories in accordance with Section 12, such as merchandise, production supplies, materials, work in progress and finished goods; (d) provisions for employee benefits and other provisions; and (e) classes of equity, such as paid-in capital, share premium, retained earnings and items of income and expense that, as required by this [draft] standard, are recognised directly in equity.

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<table>
<tr><td>4.13</td><td>An entity with share capital shall disclose the following, either on the face of the balance sheet or in the notes:
(a) for each class of share capital:
(i) the number of shares authorised;
(ii) the number of shares issued and fully paid, and issued but not fully paid;
(iii) par value per share, or that the shares have no par value;
(iv) a reconciliation of the number of shares outstanding at the beginning and at the end of the period (see paragraph 21.12 for further guidance);
(v) the rights, preferences and restrictions attaching to that class including restrictions on the distribution of dividends and the repayment of capital;
(vi) shares in the entity held by the entity or by its subsidiaries or associates;
(vii) shares reserved for issue under options and contracts for the sale of shares, including the terms and amounts; and
(b) a description of each reserve within equity.</td></tr>
<tr><td>4.14</td><td>An entity without share capital, such as a partnership or trust, shall disclose information equivalent to that required by paragraph 4.13(a), showing changes during the period in each category of equity, and the rights, preferences and restrictions attaching to each category of equity.</td></tr>
<tr><td>21.12</td><td>Paragraph 4.13(a)(iv) requires an entity with share capital to disclose, either on the face of the balance sheet or in the notes, for each class of share capital, a reconciliation of the number of shares outstanding (or other measure of quantity) at the beginning and at the end of the period. In that reconciliation, the entity shall identify separately each significant type of change in the number of shares outstanding, including new issues; exercises of options, rights and warrants; conversions of convertible securities; treasury share transactions; business combinations; and bonus issues (share dividends) and share splits.</td></tr>
</table>

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Section 5 Income Statement

Information to be presented on the face of the income statement

5.3	As a minimum, an entity shall include, on the face of the income statement, line items that present the following amounts for the period: (a) revenue; (b) finance costs; (c) share of the profit or loss of investments in associates and joint ventures accounted for using the equity method; (d) tax expense; (e) a single amount comprising the total of (i) the post-tax profit or loss of discontinued operations and (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or disposal group(s) constituting the discontinued operation (see Section 36); and (f) profit or loss.
5.4	An entity shall disclose separately the following items on the face of the income statement as allocations of profit or loss for the period: (a) profit or loss attributable to minority interest; and (b) profit or loss attributable to equity holders of the parent.

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Information to be presented either on the face of the income statement or in the notes

<table>
<tr><td>5.7</td><td>An entity shall disclose separately the nature and amount of material components of income and expense. Such disclosures shall include:
(a) write-downs of property, plant and equipment to fair value less costs to sell, and the reversal of such write-downs;
(b) write-downs of inventories to net realisable value, and the reversal of such write-downs;
(c) restructurings of the activities of an entity and reversals of any provisions for the costs of restructuring;
(d) disposals of items of property, plant and equipment;
(e) disposals of investments;
(f) discontinued operations;
(g) litigation settlements; and
(h) the reversal of other provisions.</td></tr>
<tr><td>5.9</td><td>An entity shall present an analysis of expenses using a classification based on either the nature of expenses or their function of expenses within the entity, whichever provides information that is reliable and more relevant.</td></tr>
<tr><td>5.11</td><td>Entities classifying expenses by function shall disclose additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense.</td></tr>
</table>

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Section 6 Statement of Changes in Equity and Statement of Income and Retained Earnings

Information to be presented on the face of the statement of changes in equity

6.2	An entity shall present a statement of changes in equity showing on the face of the statement: (a) profit or loss for the period; (b) each item of income and expense for the period that, as required by this [draft] standard, is recognised directly in equity, and the total of those items; (c) total income and expense for the period (calculated as the sum of (a) and (b)), showing separately the total amounts attributable to equity holders of the parent and to minority interest; and (d) for each component of equity, the effects of changes in accounting policies and corrections of errors recognised in accordance with Section 10.

Information to be presented either on the face of the statement of changes in equity or in the notes

6.3	An entity shall also present, either on the face of the statement of changes in equity or in the notes: (a) the amounts of investments by, and dividends and other distributions to, equity holders, showing separately issues of shares, treasury share transactions, and dividends and other distributions to equity holders; (b) the balance of retained earnings (ie accumulated profit or loss) at the beginning of the reporting period and at the end of the period, and the changes during the period; and (c) a reconciliation of the carrying amount of each class of contributed equity and each item of income and expense recognised directly in equity (see paragraph 6.2(b)) at the beginning and the end of the period, separately disclosing each change.

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Information to be presented on the face of the statement of income and retained earnings

6.5	An entity shall present, on the face of the statement of income and retained earnings, the following items in addition to the information required by Section 5: (a) retained earnings at the beginning of the reporting period; (b) dividends declared and paid or payable during the period; (c) restatements of retained earnings for corrections of prior period errors; (d) restatements of retained earnings for changes in accounting policy; and (e) retained earnings at the end of the reporting period.

Section 7 Cash Flow Statement

7.3	An entity shall present a cash flow statement that reports cash flows for a period classified by operating activities, investing activities and financing activities.
7.7	An entity shall report cash flows from operating activities using either: (a) the direct method, whereby major classes of gross cash receipts and gross cash payments are disclosed; or (b) the indirect method, whereby profit or loss is adjusted for the effects of non-cash transactions, any deferrals or accruals of past or future operating cash receipts or payments, and items of income or expense associated with investing or financing cash flows.

Reporting cash flows from investing and financing activities

7.10	An entity shall report separately major classes of gross cash receipts and gross cash payments arising from investing and financing activities. The aggregate cash flows arising from acquisitions and from disposals of subsidiaries or other business units shall be presented separately and classified as operating activities.

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Interest and dividends

7.14	An entity shall disclose separately cash flows from interest and dividends received and paid.

Income taxes

7.17	An entity shall disclose separately cash flows arising from taxes on income and shall classify them as cash flows from operating activities unless they can be specifically identified with financing and investing activities. When tax cash flows are allocated over more than one class of activity, the entity shall disclose the total amount of taxes paid.

Non-cash transactions

7.18	An entity shall exclude from the cash flow statement investing and financing transactions that do not require the use of cash or cash equivalents. An entity shall disclose such transactions elsewhere in the financial statements in a way that provides all the relevant information about these investing and financing activities.

Components of cash and cash equivalents

7.20	An entity shall disclose the components of cash and cash equivalents and shall present a reconciliation of the amounts reported in the cash flow statement to the equivalent items reported in the balance sheet.

Other disclosures

7.21	An entity shall disclose, together with a commentary by management, the amount of significant cash and cash equivalent balances held by the entity that are not available for use by the entity. Cash and cash equivalents held by an entity may not be available for use by the entity because of, among other reasons, foreign exchange controls or legal restrictions.

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Section 8 Notes to the Financial Statements

8.3	An entity shall, as far as practicable, present the notes in a systematic manner. An entity shall cross-reference each item on the face of the financial statements to any related information in the notes.
8.4	An entity normally presents the notes in the following order: (a) a statement that the financial statements have been prepared in compliance with the *IFRS for SMEs* (see paragraph 3.2); (b) a summary of significant accounting policies applied (see paragraph 8.5); (c) supporting information for items presented on the face of the financial statements, in the order in which each statement and each line item is presented; and (d) other disclosures, including: (i) contingent liabilities and contingent assets (see Section 20) and unrecognised contractual commitments; (ii) non-financial disclosures (iii) the amount of dividends proposed or declared before the financial statements were authorised for issue but not recognised as a distribution to equity holders during the period, and the related amount per share; and (iv) the amount of any cumulative preference dividends not recognised.

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Disclosure of accounting policies

8.5	An entity shall disclose in the summary of significant accounting policies: (a) the measurement basis (or bases) used in preparing the financial statements; (b) the accounting policy the entity has chosen whenever the entity has adopted an accounting policy for an event, a transaction, other event or condition for which this [draft] standard allows an accounting policy choice; and (c) the other accounting policies used that are relevant to an understanding of the financial statements.

Information about judgements

8.6	An entity shall disclose, in the summary of significant accounting policies or other notes, the judgements, apart from those involving estimations (see paragraph 8.7), that management has made in the process of applying the entity's accounting policies and that have the most significant effect on the amounts recognised in the financial statements.

Information about key sources of estimation uncertainty

8.7	An entity shall disclose in the notes information about the key assumptions concerning the future, and other key sources of estimation uncertainty at the end of the reporting period, that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year. In respect of those assets and liabilities, the notes shall include details of: (a) their nature; and (b) their carrying amount as at the end of the reporting period.

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Information about externally imposed capital requirements

8.8	If an entity is subject to externally imposed capital requirements, it shall disclose the nature of those requirements and how they are managed, including whether the requirements have been complied with.

Section 9 Consolidated and Separate Financial Statements

Separate financial statements

9.19	When a parent, a venturer with an interest in a jointly controlled entity or an investor in an associate prepares separate financial statements, those separate financial statements shall disclose: (a) that the statements are separate financial statements and the reasons why those statements are prepared if not required by law; (b) a list of significant investments in subsidiaries, jointly controlled entities and associates, including the name, country of incorporation or residence, proportion of ownership interest and, if different, proportion of voting power held; and (c) a description of the method used to account for the investments listed under (b); and shall identify the consolidated financial statements to which they relate.

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Combined financial statements

9.22	If an entity prepares combined financial statements and describes them as conforming to the *IFRS for SMEs*, those statements shall comply with all of the requirements of this [draft] standard. Intercompany transactions and balances shall be eliminated; profits or losses resulting from intercompany transactions that are recognised in assets such as inventory and fixed assets shall be eliminated; the financial statements of the entities included in the combined financial statements shall be prepared as of the same reporting date unless it is impracticable to do so; and uniform accounting policies shall be followed for like transactions and other events in similar circumstances. Disclosures shall include the fact that the financial statements are combined financial statements and the related party disclosures required by Section 33.

Section 10 Accounting Policies, Estimates and Errors

Disclosure of a change in accounting policy

10.11	When initial application of this [draft] standard, or an amendment to this [draft] standard, has an effect on the current period or any prior period or might have an effect on future periods, an entity shall disclose: (a) the nature of the change in accounting policy; (b) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected; (c) the amount of the adjustment relating to periods before those presented, to the extent practicable; and (d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c) above. Financial statements of subsequent periods need not repeat these disclosures.

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10.12	When a voluntary change in accounting policy has an effect on the current period or any prior period, or might have an effect on future periods, an entity shall disclose: (a) the nature of the change in accounting policy; (b) the reasons why applying the new accounting policy provides reliable and more relevant information; (c) for the current period and each prior period presented, to the extent practicable, the amount of the adjustment for each financial statement line item affected; (d) the amount of the adjustment relating to periods before those presented, to the extent practicable; and (e) an explanation if it is not practicable to determine the amounts to be disclosed in (c) or (d) above. Financial statements of subsequent periods need not repeat these disclosures.

Disclosure of a change in estimate

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

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Disclosure of prior period errors

10.23	An entity shall disclose the following about prior period errors: (a) the nature of the prior period error; (b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected; (c) the amount of the correction at the beginning of the earliest prior period presented; and (d) if retrospective restatement is impracticable for a particular prior period, the circumstances that led to the existence of that condition and a description of how and from when the error has been corrected. Financial statements of subsequent periods need not repeat these disclosures.

Section 11 Financial Assets and Financial Liabilities

Disclosure of accounting policies for financial instruments

11.40	In accordance with paragraph 8.5 of Section 8, an entity shall disclose, in the summary of significant accounting policies, the measurement basis (or bases) used for financial instruments and the other accounting policies used for financial instruments that are relevant to an understanding of the financial statements.

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Balance sheet – categories of financial assets and financial liabilities

11.41	An entity shall disclose the carrying amounts of each of the following categories of financial assets and financial liabilities, in total and by each significant type of financial asset or financial liability within each category, either on the face of the balance sheet or in the notes: (a) financial assets measured at fair value through profit or loss (paragraph 11.8); (b) financial assets measured at amortised cost less impairment (paragraph 11.7(a)); (c) equity instruments measured at cost (paragraph 11.7(c)); (d) forward commitments and options measured at cost less impairment (paragraph 11.7(b)); (e) financial liabilities measured at fair value through profit or loss (paragraph 11.8); and (f) financial liabilities measured at amortised cost (paragraph 11.7(a)).
11.42	For all financial assets and financial liabilities measured at fair value, the entity shall disclose the basis for determining fair value, eg quoted market price in an active market or a valuation technique. When a valuation technique is used, the entity shall disclose 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.
11.43	If a reliable measure of fair value is no longer available for an equity instrument measured at fair value through profit or loss, the entity shall disclose that fact.

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Derecognition

11.44	If an entity has transferred financial assets to another party in a transaction that does not qualify for derecognition (see paragraphs 11.24–11.26), 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) the carrying amounts of the assets and of any associated liabilities that the entity continues to recognise.

Collateral

11.45	When an entity has pledged financial assets as collateral for liabilities or contingent liabilities, it shall disclose: (a) the carrying amount of the financial assets pledged as collateral; and (b) the terms and conditions relating to its pledge.

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Defaults and breaches on loans payable

11.46	For loans payable recognised at the reporting date, 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 reporting date; and (c) whether the default was remedied, or the terms of the loans payable were renegotiated, before the financial statements were authorised for issue.
11.47	If, during the period, there were breaches of loan agreement terms other than those described in paragraph 11.46, an entity shall disclose the same information as required by paragraph 11.46 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 reporting date).

Income statement and equity – items of income, expense, gains or losses

11.48	An entity shall disclose the following items of income, expense, gains or losses either on the face of the financial statements or in the notes: (a) net gains or net losses recognised on: (i) financial assets measured at fair value through profit or loss; (ii) financial liabilities measured at fair value through profit or loss; (iii) financial assets measured at amortised cost; and (iv) financial liabilities measured at amortised cost; (b) total interest income and total interest expense (calculated using the effective interest method) for financial assets or financial liabilities that are not at fair value through profit or loss; and (c) the amount of any impairment loss for each class of financial asset.

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Hedge accounting

11.49	An entity shall disclose the following separately for each type of hedge described in paragraph 11.31: (a) a description of the hedge; (b) a description of the financial instruments designated as hedging instruments and their fair values at the reporting date; and (c) the nature of the risks being hedged, including a description of the hedged item.
11.50	For a hedge of fixed interest rate risk or commodity price risk of a commodity held (paragraphs 11.33–11.36) the entity shall disclose: (a) the amount of the change in fair value of the hedging instrument recognised in profit or loss and (b) the amount of the change in fair value of the hedged item recognised in profit or loss.
11.51	For a hedge of variable interest rate risk, foreign exchange risk, commodity price risk in a firm commitment or highly probable forecast transaction, or a net investment in a foreign operation (paragraphs 11.37–11.39) the entity shall disclose: (a) the periods when the cash flows are expected to occur and when they are expected to affect profit or loss; (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 of the change in fair value of the hedging instrument that was recognised in equity during the period (paragraph 11.37); (d) the amount that was removed from equity and recognised in profit or loss for the period, showing the amount included in each line item in the income statement (paragraphs 11.38 and 11.39).

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Risks relating to financial instruments measured at cost or amortised cost

11.52	For financial assets measured at amortised cost less impairment, the entity shall disclose the significant terms and conditions that may affect the amount, timing and certainty of future cash flows, including interest rate risk, foreign currency exchange rate risk and credit risk.

Section 12 Inventories

12.21	An entity shall disclose: (a) the accounting policies adopted in measuring inventories, including the cost formula used; (b) the total carrying amount of inventories and the carrying amount in classifications appropriate to the entity; (c) the amount of inventories recognised as an expense during the period ('cost of goods sold'); (d) the amount of any impairment of inventories recognised as an expense in the period in accordance with paragraph 12.18 and paragraphs 26.2–26.4; (e) the amount of any reversal of any impairment recognised in the period in accordance with paragraph 12.18 and paragraph 26.4, and a description of the circumstances or events that led to such reversal; and (f) the carrying amount of inventories pledged as security for liabilities.

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Section 13 Investments in Associates

13.7	An investor in an associate shall disclose: (a) its accounting policy for investments in associates; (b) the fair value of investments in associates for which there are published price quotations; (c) summarised financial information of associates, including the aggregated amounts of assets, liabilities, revenues and profit or loss, along with the investor's percentage of ownership of the associates; and (d) the nature and extent of any significant restrictions (eg resulting from borrowing arrangements or regulatory requirements) on the ability of associates to transfer funds to the investor in the form of cash dividends, or repayment of loans or advances.

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Section 14 Investments in Joint Ventures

14.16	An investor in a joint venture shall disclose the aggregate amount of the following contingent liabilities, unless the probability of loss is remote, separately from the amount of other contingent liabilities: (a) any contingent liabilities that the investor has incurred in relation to its interests in joint ventures and its share in each of the contingent liabilities that have been incurred jointly with other venturers; (b) its share of the contingent liabilities of the joint ventures themselves for which it is contingently liable; and (c) those contingent liabilities that arise because the investor is contingently liable for the liabilities of the other venturers of a joint venture.
14.17	An investor in a joint venture shall also disclose: (a) the aggregate amount of its commitments relating to joint ventures, including its share in the capital commitments that have been incurred jointly with other venturers, as well as its share of the capital commitments of the joint ventures themselves; (b) a listing and description of interests in significant joint ventures and the proportion of ownership interest held in jointly controlled entities; and (c) the method it uses to recognise its interests in jointly controlled entities.

Section 15 Investment Property

Fair value model

15.5	An entity that elects to use the fair value model shall apply IAS 40 *Investment Property* (see especially paragraphs 33–55), and shall make the disclosures required by paragraphs 76–78 of that standard.

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Cost model

15.6	An entity that elects to use the cost model shall account for all of its investment property as property, plant and equipment in accordance with the requirements for the cost model in Section 16. The entity shall make the disclosures required by that section.

Section 16 Property, Plant and Equipment

16.29	An entity shall disclose, for each class of property, plant and equipment: (a) the measurement bases used for determining the gross carrying amount; (b) the depreciation methods used; (c) the useful lives or the depreciation rates used; (d) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period; and (e) a reconciliation of the carrying amount at the beginning and end of the period showing: (i) additions; (ii) disposals, including assets classified as held for sale or included in a disposal group classified as held for sale; (iii) acquisitions through business combinations; (iv) impairment losses recognised or reversed in profit or loss in accordance with Section 26; (v) depreciation; (vi) the net exchange differences arising on the translation of the financial statements from the functional currency into a different presentation currency, including the translation of a foreign operation into the presentation currency of the reporting entity (see Section 30); and (vii) other changes.

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16.30	The entity shall also disclose: (a) the existence and amounts of restrictions on title, and property, plant and equipment pledged as security for liabilities; (b) the amount of contractual commitments for the acquisition of property, plant and equipment; and (c) if it is not disclosed separately on the face of the income statement, the amount of compensation from third parties for items of property, plant and equipment that were impaired, lost or given up that is recognised in profit or loss.
16.31	An entity shall present property, plant and equipment that is held for sale separately from other assets on the face of the balance sheet. The entity shall present any liabilities related to property, plant and equipment that is held for sale separately from other liabilities on the face of the balance sheet.

Section 17 Intangible Assets other than Goodwill

17.23	An entity that uses the revaluation model shall apply paragraphs 75-87 of IAS 38 *Intangible Assets* and shall make the disclosures required by paragraphs 124 and 125 of IAS 38.
17.32	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 amortisation rates used; (b) the amortisation methods used for intangible assets with finite useful lives; (c) the gross carrying amount and any accumulated amortisation (aggregated with accumulated impairment losses) at the beginning and end of the period; (d) the line item(s) of the income statement in which any amortisation of intangible assets is included; (e) a reconciliation of the carrying amount at the beginning and end of the period showing separately additions, disposals, amortisations, impairment losses, and other changes.

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<table>
<tr><td>17.33</td><td>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 amortisation period of any individual intangible asset that is material to the entity's financial statements.
(c) for intangible assets acquired by way of a government grant and initially recognised at fair value (see paragraph 17.10):
(i) the fair value initially recognised for these assets;
(ii) their carrying amount; and
(iii) whether they are measured after recognition using 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.</td></tr>
<tr><td>17.34</td><td>An entity shall disclose the aggregate amount of research and development expenditure recognised as an expense during the period.</td></tr>
</table>

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Section 18 Business Combinations and Goodwill

For business combinations effected during the reporting period

18.23	For each business combination that was effected during the period (or group of individually immaterial business combinations), the acquirer shall disclose the following: (a) the names and descriptions of the combining entities or businesses. (b) the acquisition date. (c) the percentage of voting equity instruments acquired. (d) the cost of the combination and a description of the components of that cost, including any costs directly attributable to the combination. When equity instruments are issued or issuable as part of the cost, the following shall also be disclosed: (i) the number of equity instruments issued or issuable; and (ii) the fair value of those instruments and the basis for determining that fair value. (e) details of any operations the entity has decided to dispose of as a result of the combination. (f) the amounts recognised at the acquisition date for each class of the acquiree's assets, liabilities and contingent liabilities, including goodwill. (g) the amount of any excess recognised in profit or loss in accordance with paragraph 18.22, and the line item in the income statement in which the excess is recognised. (h) a description of the factors that contributed to a cost that results in the recognition of goodwill—a description of each intangible asset that was not recognised separately from goodwill and an explanation of why the intangible asset's fair value could not be measured reliably—or a description of the nature of any excess recognised in profit or loss in accordance with paragraph 18.22.
	continued...

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...continued		
	(i)	the amount of the acquiree's profit or loss since the acquisition date included in the acquirer's profit or loss for the period, unless disclosure would be impracticable. If such disclosure would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

For business combinations effected after the end of the reporting period but before the financial statements are authorised for issue

18.24	For each business combination effected after the end of the reporting period but before the financial statements are authorised for issue, the acquirer shall make the disclosures required by paragraph 18.23 unless such disclosure would be impracticable. If disclosure of any of that information would be impracticable, that fact shall be disclosed, together with an explanation of why this is the case.

For all business combinations

18.25	An acquirer shall disclose a reconciliation of the carrying amount of goodwill at the beginning and end of the reporting period, showing separately changes arising from new business combinations, impairment losses, disposals of previously acquired businesses, and other changes. An acquirer shall also disclose the gross amount and accumulated impairment losses at the end of the period.

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Section 19 Leases

Financial statements of lessees – finance leases

19.12	Lessees shall make the following disclosures for finance leases: (a) for each class of asset, the net carrying amount at the end of the reporting period. (b) the total of future minimum lease payments at the end of the reporting period, for each future year. (c) contingent rents recognised as an expense. (d) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the end of the reporting period. (e) a general description of the lessee's leasing arrangements including, but not limited to, the following: (i) the basis on which contingent rent payable is determined; (ii) the existence and terms of renewal or purchase options and escalation clauses; and (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt and further leasing.

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Financial statements of lessees – operating leases

19.14	Lessees shall make the following disclosures for operating leases: (a) the total of future minimum lease payments under non-cancellable operating leases for each future year. (b) the total of future minimum sublease payments expected to be received under non-cancellable subleases at the end of the reporting period. (c) lease and sublease payments recognised as an expense, with separate amounts for minimum lease payments, contingent rents, and sublease payments. (d) a general description of the lessee's significant leasing arrangements including, but not limited to, the following: (i) the basis on which contingent rent payable is determined; (ii) the existence and terms of renewal or purchase options and escalation clauses; and (iii) restrictions imposed by lease arrangements, such as those concerning dividends, additional debt and further leasing.

Financial statements of lessors: finance leases

19.15	A lessor in a finance lease shall apply paragraphs 36–46 of IAS 17 *Leases* and shall make the disclosures required by paragraph 47 of IAS 17.

Financial statements of lessors: operating leases

19.23	Lessors shall disclose the following for operating leases: (a) the future minimum lease payments under non-cancellable operating leases in the aggregate and for each future year. (b) total contingent rents recognised as income. (c) a general description of the lessor's leasing arrangements.

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Sale and leaseback transactions

19.27	Disclosure requirements for lessees and lessors apply equally to sale and leaseback transactions. The required description of leasing arrangements includes description of unique or unusual provisions of the agreement or terms of the sale and leaseback transactions.

Section 20 Provisions and Contingencies

Disclosures about provisions

20.14	For each class of provision, an entity shall disclose: (a) the carrying amount at the beginning and end of the period. (b) additional provisions made in the period, including increases to existing provisions. (c) amounts used (ie incurred and charged against the provision) during the period. (d) unused amounts reversed during the period. (e) the increase during the period in the discounted amount arising from the passage of time and the effect of any change in the discount rate. (f) a brief description of the nature of the obligation and the expected timing of any resulting outflows of economic benefits. (g) an indication of the uncertainties about the amount or timing of those outflows. (h) the amount of any expected reimbursement, stating the amount of any asset that has been recognised for that expected reimbursement. Comparative information is not required.

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Disclosures about contingent liabilities

20.15	Unless the possibility of any outflow in settlement is remote, an entity shall disclose for each class of contingent liability at the end of the reporting period a brief description of the nature of the contingent liability and, when practicable: (a) an estimate of its financial effect, measured in accordance with paragraphs 20.6–20.9. (b) an indication of the uncertainties relating to the amount or timing of any outflow. (c) the possibility of any reimbursement. If it is impracticable to make one or more of these disclosures, that fact shall be stated.

Disclosures about contingent assets

20.16	If an inflow of economic benefits is probable (more likely than not) but not virtually certain, an entity shall disclose a description of the nature of the contingent assets at the end of the reporting period, and, when practicable, an estimate of their financial effect, measured using the principles set out in paragraphs 20.8–20.11. If it is impracticable to make this disclosure, that fact shall be stated.

Prejudicial disclosures

20.17	In extremely rare cases, disclosure of some or all of the information required by paragraphs 20.14–20.16 can be expected to prejudice seriously the position of the entity in a dispute with other parties on the subject matter of the provision, contingent liability or contingent asset. In such cases, an entity need not disclose the information, but shall disclose the general nature of the dispute, together with the fact that, and reason why, the information has not been disclosed.

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Section 21 Equity

No disclosures required by this section (but see paragraph 4.13).

Section 22 Revenue

22.28	An entity shall disclose: (a) the accounting policies adopted for the recognition of revenue, including the methods adopted to determine the stage of completion of transactions involving the rendering of services. (b) the amount of each category of revenue recognised during the period, including revenue arising from: (i) the sale of goods; (ii) the rendering of services; (iii) interest; (iv) royalties; (v) dividends. (c) the amount of revenue arising from exchanges of goods or services included in each category of revenue.

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Disclosures relating to revenue from construction contracts

22.29	An entity shall disclose: (a) the amount of contract revenue recognised as revenue in the period; (b) the methods used to determine the contract revenue recognised in the period; and (c) the methods used to determine the stage of completion of contracts in progress.
22.30	An entity shall disclose each of the following for contracts in progress at the balance sheet date: (a) the aggregate amount of costs incurred and recognised profits (less recognised losses) to date; (b) the amount of advances received; and (c) the amount of retentions (progress billings that are not paid until the satisfaction of conditions specified in the contract for the payment of such amounts or until defects have been rectified).
22.31	An entity shall present: (a) the gross amount due from customers for contract work as an asset; and (b) the gross amount due to customers for contract work as a liability.

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Section 23 Government Grants

23.5	An entity shall disclose the following regardless of which choice it has made under paragraph 23.3: (a) the accounting policy adopted for government grants, including an explanation of how the grant is presented in the financial statements; (b) the nature and amounts of government grants recognised in the financial statements; (c) unfulfilled conditions and other contingencies attaching to government grants that have not been recognised in income; and (d) an indication of other forms of government assistance from which the entity has directly benefited.

Section 24 Borrowing Costs

24.5	An entity shall disclose the accounting policy adopted for borrowing costs. If the capitalisation model is adopted as provided in paragraph 24.4, the entity shall include the relevant disclosures required by IAS 23 *Borrowing Costs*.

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Section 25 Share-based Payment

25.8	An entity shall disclose a description of each type of share-based payment arrangement that existed at any time during the period, including the general terms and conditions of each arrangement, such as vesting requirements, the maximum term of options granted, and the method of settlement (eg whether in cash or equity). An entity with substantially similar types of share-based payment arrangements may aggregate this information.
25.9	An entity shall disclose the following information about the effect of share-based payment transactions on the entity's profit or loss for the period and on its financial position, including at least the following: (a) the total expense recognised for the period arising from share-based payment transactions in which the goods or services received did not qualify for recognition as assets and hence were recognised immediately as an expense, including separate disclosure of that portion of the total expense that arises from transactions accounted for as equity-settled share-based payment transactions. (b) with respect to liabilities arising from share-based payment transactions: (i) the total carrying amount at the end of the period; and (ii) the total intrinsic value at the end of the period of liabilities for which the counterparty's right to cash or other assets had vested by the end of the period (eg vested share appreciation rights).

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Section 26 Impairment of Non-financial Assets

26.25	An entity shall disclose the following for each class of assets: (a) the amount of impairment losses recognised in profit or loss during the period and the line item(s) of the income statement in which those impairment losses are included. (b) the amount of reversals of impairment losses recognised in profit or loss during the period and the line item(s) of the income statement in which those impairment losses are reversed. (c) the amount of impairment losses on revalued assets recognised directly in equity during the period. (d) the amount of reversals of impairment losses on revalued assets recognised directly in equity during the period.
26.26	An entity shall disclose the following information for the aggregate impairment losses and the aggregate reversals of impairment losses recognised during the period for which no separate information is disclosed: (a) the main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses. (b) the main events and conditions that led to the recognition of these impairment losses and reversals of impairment losses.

Section 27 Employee Benefits

Disclosures about short-term employee benefits

27.36	Section 27 does not require specific disclosures about short-term employee benefits.

Disclosures about defined contribution plans

27.37	An entity shall disclose the total cost of defined contribution plans for the period and their amounts (a) recognised in profit or loss as an expense and (b) included in the cost of an asset.

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Disclosures about defined benefit plans

27.38 An entity shall disclose the following information about defined benefit plans:

(a) a general description of the type of plan, including funding policy.

(b) the entity's accounting policy for recognising actuarial gains and losses and the amount of actuarial gains and losses recognised during the period.

(c) a reconciliation of opening and closing balances of the defined benefit liability showing separately benefits paid and all other changes.

(d) an analysis of the defined benefit liability into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded.

(e) a reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognised as an asset, showing separately, if applicable:

   (i) contributions by the employer;

   (ii) contributions by plan participants;

   (iii) benefits paid; and

   (iv) other changes in plan assets.

(f) the total cost relating to defined benefit plans recognised in profit or loss as an expense for the period, and the line item(s) in which they are included.

(g) the total cost relating to defined benefit plans during the period that was:

   (i) included in the cost of producing inventories in accordance with Section 12; or

   (ii) included in the cost of property, plant and equipment in accordance with Section 16.

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...continued

(h) for each major category of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total plan assets.

(i) the amounts included in the fair value of plan assets for:

  (i) each category of the entity's own financial instruments; and

  (ii) any property occupied by, or other assets used by, the entity.

(j) the actual return on plan assets.

(k) the principal actuarial assumptions used, including, when applicable:

  (i) the discount rates;

  (ii) the expected rates of return on any plan assets for the periods presented in the financial statements;

  (iii) the expected rates of salary increases; and

  (iv) medical cost trend rates.

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Disclosures about other long-term benefits

27.39	For each category of other long-term benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, the amount of its obligation and the funding status at the balance sheet date, and the amount of any actuarial gains and losses arising in the current period and its accounting policy for such actuarial gains and losses.

Disclosures about termination benefits

27.40	For each category of termination benefits that an entity provides to its employees, the entity shall disclose the nature of the benefit, its accounting policy, and the amount of its obligation and the funding status at the balance sheet date.
27.41	When there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. Section 20 requires an entity to disclose information about its contingent liability unless the possibility of an outflow in settlement is remote.

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Section 28 Income Taxes

28.28	An entity shall disclose separately the major components of tax expense (income). Such components of tax expense (income) may include: (a) current tax expense (income). (b) any adjustments recognised in the period for current tax of prior periods. (c) the amount of deferred tax expense (income) relating to the origination and reversal of temporary differences. (d) the amount of deferred tax expense (income) relating to changes in tax rates or the imposition of new taxes. (e) the amount of the benefit arising from a previously unrecognised tax loss, tax credit or temporary difference of a prior period that is used to reduce current tax expense. (f) deferred tax expense (or income) arising from the impairment, or reversal of a previous impairment, of a deferred tax asset (see paragraph 28.26).

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28.29	An entity shall disclose the following separately: (a) the aggregate current and deferred tax relating to items that are recognised directly in equity. (b) a numerical reconciliation between tax expense (income) as recognised and tax expense (income) that would be expected by multiplying profit by the applicable tax rate(s), with each significant difference disclosed separately. (c) an explanation of changes in the applicable tax rate(s) compared with the previous reporting period. (d) the amount (and expiry date, if any) of temporary differences, unused tax losses, and unused tax credits for which no deferred tax asset is recognised. (e) the aggregate amount of temporary differences associated with investments in foreign subsidiaries, branches and associates and joint ventures, for which deferred tax liabilities have not been recognised (see paragraph 28.18(b)). (f) the aggregate amount of temporary differences associated with the initial recognition of goodwill for which deferred tax liabilities have not been recognised (see paragraph 28.18(c))
28.30	In the circumstances described in paragraph 28.25, an entity shall disclose the nature of the potential income tax consequences that would result from the payment of dividends to its shareholders. In addition, the entity shall disclose the amounts of the potential income tax consequences, if practicably determinable, and whether there are any potential income tax consequences not practicably determinable.

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Section 29 Financial Reporting in Hyperinflationary Economies

29.2	An entity whose functional currency is the currency of a hyperinflationary economy shall apply IAS 29 *Financial Reporting in Hyperinflationary Economies* in preparing and presenting its financial statements in accordance with this [draft] standard.

Section 30 Foreign Currency Translation

30.25	In paragraphs 30.27 and 30.29, references to 'functional currency' apply, in the case of a group, to the functional currency of the parent.
30.26	An entity shall disclose: (a) the amount of exchange differences recognised in profit or loss except for those arising on financial instruments measured at fair value through profit or loss in accordance with Section 11. (b) net exchange differences classified in a separate component of equity, and a reconciliation of the amount of such exchange differences at the beginning and end of the period.
30.27	An entity shall disclose the currency in which the financial statements are presented. When the presentation currency is different from the functional currency, an entity shall state that fact and shall disclose the functional currency and the reason for using a different presentation currency.
30.28	When there is a change in the functional currency of either the reporting entity or a significant foreign operation, the entity shall disclose that fact and the reason for the change in functional currency.

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30.29	When an entity displays its financial statements or other financial information in a currency that is different from either its functional currency or its presentation currency (for example, a 'convenience translation' of all amounts at closing rate), it shall: (a) clearly identify the information as supplementary information to distinguish it from the information that complies with this [draft] standard; (b) disclose the currency in which the supplementary information is displayed; and (c) disclose the entity's functional currency and the method of translation used to determine the supplementary information.

Section 31 Segment Reporting

31.1	An entity using this [draft] standard is not required to present information about operating segments. An entity that chooses to disclose segment information in financial statements described as conforming to the *IFRS for SMEs* shall comply fully with the requirements of IFRS 8 *Operating Segments*. If an entity discloses information about segments that does not comply with IFRS 8, it shall not describe the information as segment information.

Section 32 Events after the End of the Reporting Period

Date of authorisation for issue

32.8	An entity shall disclose the date when the financial statements were authorised for issue and who gave that authorisation. If the entity's owners or others have the power to amend the financial statements after issue, the entity shall disclose that fact.

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Non-adjusting events after the end of the reporting period

32.9	An entity shall disclose the following for each category of non-adjusting event after the end of the reporting period: (a) the nature of the event; and (b) an estimate of its financial effect, or a statement that such an estimate cannot be made.
32.10	The following are examples of non-adjusting events after the end of the reporting period that would generally result in disclosure: (a) a major business combination (Section 18 requires specific disclosures in such cases) or disposing of a major subsidiary. (b) announcing a plan to discontinue an operation. (c) major purchases of assets, classification of assets as held for sale in accordance with Section 16, other disposals of assets, or expropriation of major assets by government. (d) the destruction of a major production plant by a fire. (e) announcing, or commencing the implementation of, a major restructuring (see Section 20). (f) major ordinary share transactions and potential ordinary share transactions. (g) abnormally large changes in asset prices or foreign exchange rates. (h) changes in tax rates or tax laws enacted or announced that have a significant effect on current and deferred tax assets and liabilities (see Section 28). (i) entering into significant commitments or contingent liabilities, for example, by issuing significant guarantees. (j) commencing major litigation arising solely out of events that occurred after the end of the reporting period.

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Section 33 Related Party Disclosures

Disclosure of relationships

33.4	Relationships between parents and subsidiaries shall be disclosed irrespective of whether there have been transactions between those related parties. An entity shall disclose the name of the entity's parent and, if different, the ultimate controlling party. If neither the entity's parent nor the ultimate controlling party produces financial statements available for public use, the name of the next most senior parent that does so (if any) shall also be disclosed.

Disclosure of key management personnel compensation

33.5	Key management personnel are those persons having authority and responsibility for planning, directing and controlling the activities of the entity, directly or indirectly, including any director (whether executive or otherwise) of that entity. Compensation includes all employee benefits (as defined in Section 27) including those in the form of share-based payment (see Section 25). Employee benefits include all forms of consideration paid, payable or provided by the entity, or on behalf of the entity (for example, by its parent or by a shareholder), in exchange for services rendered to the entity. It also includes such consideration paid on behalf of a parent of the entity in respect of the entity.
33.6	An entity shall disclose key management personnel compensation in total and for each of the following categories: (a) short-term employee benefits; (b) post-employment benefits; (c) other long-term benefits; (d) termination benefits; and (e) share-based payment.

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Disclosure of related party transactions

<table>
<tr><td>33.7</td><td>A related party transaction is a transfer of resources, services or obligations between related parties, regardless of whether a price is charged. Examples of related party transactions that are common to SMEs include, but are not limited to:
(a) transactions between an entity and its principal owner(s).
(b) transactions between an entity and another entity where both entities are under the common control of a single entity or individual.
(c) transactions in which an entity or individual that controls the reporting entity incurs expenses directly that otherwise would have been borne by the reporting entity.</td></tr>
<tr><td>33.8</td><td>If there have been transactions between related parties, an entity shall disclose the nature of the related party relationship as well as information about the transactions and outstanding balances necessary for an understanding of the potential effect of the relationship on the financial statements. These disclosure requirements are in addition to the requirements in paragraph 33.6 to disclose key management personnel compensation. At a minimum, disclosures shall include:
(a) the amount of the transactions.
(b) the amount of outstanding balances and:
(i) their terms and conditions, including whether they are secured, and the nature of the consideration to be provided in settlement; and
(ii) details of any guarantees given or received.
(c) provisions for uncollectible receivables related to the amount of outstanding balances.
(d) the expense recognised during the period in respect of bad or doubtful debts due from related parties.</td></tr>
</table>

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<table>
<tr><td>33.9</td><td>An entity shall make the disclosures required by paragraph 33.8 separately for each of the following categories:
(a) the parent.
(b) entities with joint control or significant influence over the entity.
(c) subsidiaries.
(d) associates.
(e) joint ventures in which the entity is a venturer.
(f) key management personnel of the entity or its parent (in the aggregate).
(g) other related parties.</td></tr>
<tr><td>33.10</td><td>The following are examples of transactions that are disclosed if they are with a related party:
(a) purchases or sales of goods (finished or unfinished).
(b) purchases or sales of property and other assets.
(c) rendering or receiving of services.
(d) leases.
(e) transfers of research and development.
(f) transfers under licence agreements.
(g) transfers under finance arrangements (including loans and equity contributions in cash or in kind).
(h) provision of guarantees or collateral.
(i) settlement of liabilities on behalf of the entity or by the entity on behalf of another party.
(j) participation by a parent or subsidiary in a defined benefit plan that shares risks between group entities.</td></tr>
<tr><td>33.11</td><td>An entity shall not state that related party transactions were made on terms equivalent to those that prevail in arm's length transactions unless such terms can be substantiated.</td></tr>
</table>

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33.12	An entity may disclose items of a similar nature in the aggregate except when separate disclosure is necessary for an understanding of the effects of related party transactions on the financial statements of the entity.

Section 34 Earnings per Share

34.1	An entity using this [draft] standard is not required to present amounts of earnings per share. However, if the entity discloses earnings per share, it shall calculate and disclose earnings per share in accordance with IAS 33 *Earnings per Share*.

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Section 35 Specialised Industries

Agriculture

<table>
<tr><td>35.1</td><td>An entity using this [draft] standard that is engaged in agricultural activity shall determine, for each of its biological assets, whether the fair value of that biological asset is readily determinable without undue cost and effort:

(a) The entity shall apply the fair value model in paragraphs 10–29 of IAS 41 Agriculture to account for those biological assets whose fair value is readily determinable without undue cost or effort, and the entity shall make all related disclosures required by IAS 41.

(b) The entity shall measure at cost less any accumulated depreciation and any accumulated impairment losses those biological assets whose fair value is not readily determinable without undue cost or effort. The entity shall disclose, for such biological assets:

(i) a description of the biological assets;
(ii) an explanation of why fair value cannot be measured reliably;
(iii) if possible, the range of estimates within which fair value is highly likely to lie;
(iv) the depreciation method used;
(v) the useful lives or the depreciation rates used; and
(vi) the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.</td></tr>
</table>

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Section 36 Discontinued Operations and Assets Held for Sale

Presentation and disclosure

36.2	An entity shall disclose: (a) a single amount on the face of the income statement comprising the total of: (i) the post-tax profit or loss of discontinued operations; and (ii) the post-tax gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or group(s) of assets and liabilities constituting the discontinued operation. (b) an analysis of the single amount in (a) into: (i) the revenue, expenses, pre-tax profit or loss and income tax expense of discontinued operations; (ii) the gain or loss recognised on the measurement to fair value less costs to sell or on the disposal of the assets or group(s) of assets constituting the discontinued operation and the related income tax expense. The analysis may be presented in the notes or on the face of the income statement. If it is presented on the face of the income statement it shall be presented in a section identified as relating to discontinued operations, ie separately from continuing operations. (c) the net cash flows attributable to the operating, investing and financing activities of discontinued operations. These disclosures may be presented either in the notes or on the face of the financial statements.
36.3	Unless impracticable, an entity shall restate the disclosures in the preceding paragraph for prior periods presented in the financial statements so that the disclosures relate to all operations that have been discontinued by the end of the reporting period for the latest period presented.

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36.4	If an entity ceases to classify a component of an entity as held for sale, the entity shall reclassify the results of operations of the component previously presented in discontinued operations and shall include them in income from continuing operations for all periods presented. The amounts for prior periods shall be described as having been restated.

Non-current assets held for sale

36.8	An entity shall disclose the following information in the period in which property, plant and equipment has been either classified as held for sale or sold: (a) a description of the asset or disposal group; (b) a description of the facts and circumstances of the sale, or leading to the expected disposal, and the expected manner and timing of that disposal; and (c) the gain or loss recognised, if not separately presented on the face of the income statement.

Section 37 Interim Financial Reporting

37.1	An entity that issues an interim financial report that is described as complying with this [draft] standard shall apply either IAS 34 *Interim Financial Reporting* or all of the requirements of this [draft] standard, except as provided in paragraph 37.2.

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Section 38 Transition to the *IFRS for SMEs*

Explanation of transition to the *IFRS for SMEs*

38.10	An entity shall explain how the transition from its previous GAAP to this [draft] standard affected its reported financial position, financial performance and cash flows.

Reconciliations

38.11	To comply with paragraph 38.10, an entity's first financial statements prepared using this [draft] standard shall include: (a) reconciliations of its equity reported under previous GAAP to its equity under the [draft] standard for both of the following dates: (i) the date of transition to this [draft] standard; and (ii) the end of the latest period presented in the entity's most recent annual financial statements under previous GAAP; and (b) a reconciliation of the profit or loss reported under previous GAAP for the latest period in the entity's most recent annual financial statements to its profit or loss under this [draft] standard for the same period.
38.12	If an entity becomes aware of errors made under previous GAAP, the reconciliations required by paragraph 39.11(a) and (b) shall distinguish the correction of those errors from changes in accounting policies.
38.13	If an entity did not present financial statements for previous periods, it shall disclose that fact in its first financial statements that conform to this [draft] standard.

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