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2009 HANDBOOK OF INTERNATIONAL PUBLIC SECTOR ACCOUNTING PRONOUNCEMENTS

Volume II

Scope of the Handbook

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

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IPSAS 20—RELATED PARTY DISCLOSURES

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 24 (reformatted 1994), "Related Party Disclosures" published by the International Accounting Standards Board (IASB). Extracts from IAS 24 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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

E-mail: publications@iasb.org
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IPSAS 20—RELATED PARTY DISCLOSURES

CONTENTS

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

Objective

The objective of this Standard is to require the disclosure of the existence of related party relationships where control exists and the disclosure of information about transactions between the entity and its related parties in certain circumstances. This information is required for accountability purposes and to facilitate a better understanding of the financial position and performance of the reporting entity. The principal issues in disclosing information about related parties are identifying which parties control or significantly influence the reporting entity and determining what information should be disclosed about transactions with those parties.

Scope

1. **An entity which prepares and presents financial statements under the accrual basis of accounting should apply this Standard in disclosing information about related party relationships and certain transactions with related parties.**

2. **This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).**

3. The "Preface to International Public Sector Accounting Standards" issued by the IPSASB explains that GBEs apply International Financial Reporting Standards (IFRSs) which are issued by the International Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, "Presentation of Financial Statements."

Definitions

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

   Close members of the family of an individual are close relatives of the individual or members of the individual's immediate family who can be expected to influence, or be influenced by, that individual in their dealings with the entity.

   Key management personnel are:

   (a) **All directors or members of the governing body of the entity; and**

   (b) **Other persons having the authority and responsibility for planning, directing and controlling the activities of the reporting**

entity. Where they meet this requirement key management personnel include:

(i) **Where there is a member of the governing body of a whole-of-government entity who has the authority and responsibility for planning, directing and controlling the activities of the reporting entity, that member;**

(ii) **Any key advisors of that member; and**

(iii) **Unless already included in (a), the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity.**

Oversight means the supervision of the activities of an entity, with the authority and responsibility to control, or exercise significant influence over, the financial and operating decisions of the entity.

Related party parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control. Related parties include:

(a) **Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the reporting entity;**

(b) **Associates (see IPSAS 7, "Investments in Associates");**

(c) **Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual;**

(d) **Key management personnel, and close members of the family of key management personnel; and**

(e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.

Related party transaction is a transfer of resources or obligations between related parties, regardless of whether a price is charged. Related party transactions exclude transactions with any other entity that is a related party solely because of its economic dependence on the reporting entity or the government of which it forms part.

Remuneration of key management personnel is any consideration or benefit derived directly or indirectly by key management personnel from the reporting entity for services provided in their capacity as

members of the governing body or otherwise as employees of the reporting entity.

Significant influence (for the purpose of this Standard) is the power to participate in the financial and operating policy decisions of an entity, but not control those policies. Significant influence may be exercised in several ways, usually by representation on the board of directors or equivalent governing body but also by, for example, participation in the policy making process, material transactions between entities within an economic entity, interchange of managerial personnel or dependence on technical information. Significant influence may be gained by an ownership interest, statute or agreement. With regard to an ownership interest, significant influence is presumed in accordance with the definition contained in IPSAS 7.

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

Close Member of the Family of an Individual

5. Judgment will be necessary in determining whether an individual should be identified as a close member of the family of an individual for purposes of application of this Standard. In the absence of information to the contrary, such as that a spouse or other relative is estranged from the individual, the following immediate family members and close relatives are presumed to have, or be subject to, such influence as to satisfy the definition of close members of the family of an individual:

   (a) A spouse, domestic partner, dependent child or relative living in a common household;

   (b) A grandparent, parent, nondependent child, grandchild, brother or sister; and

   (c) The spouse or domestic partner of a child, a parent-in-law, a brother-in-law or a sister-in-law.

Key Management Personnel

6. Key management personnel include all directors or members of the governing body of the reporting entity where that body has the authority and responsibility for planning, directing and controlling the activities of the entity. At the whole-of-government level, the governing body may consist of elected or appointed representatives (for example, a president or governor, ministers, councilors and aldermen or their nominees).

7. Where an entity is subject to the oversight of an elected or appointed representative of the governing body of the government to which the entity

belongs, that person is included in key management personnel if the oversight function includes the authority and responsibility for planning, directing and controlling the activities of the entity. In many jurisdictions, key advisors of that person may not possess sufficient authority, legal or otherwise, to satisfy the definition of key management personnel. In other jurisdictions, key advisors of that person may be deemed to be key management personnel because they have a special working relationship with an individual who has control over an entity. They therefore have access to privileged information and may also be able to exercise control or significant influence over an entity. Judgment is required in assessing whether an individual is a key advisor and whether that advisor satisfies the definition of key management personnel, or is a related party.

8. The governing body, together with the chief executive and senior management group has the authority and responsibility to plan and control the activities of the entity, to manage the resources of the entity and for the overall achievement of entity objectives. Therefore, key management personnel will include the chief executive and senior management group of the reporting entity. In some jurisdictions, civil servants will not have sufficient authority and responsibility to qualify as key management personnel (as defined by this Standard) of the whole-of-government reporting entity. In these cases, key management personnel will consist only of those elected members of the governing body who have the greatest responsibility for the government, often these persons are referred to as Cabinet Ministers.

9. The senior management group of an economic entity may comprise individuals from both the controlling entity and other entities that collectively make up the economic entity.

Related Parties

10. In considering each possible related party relationship, attention is directed to the substance of the relationship, and not merely the legal form.

11. Where two entities have a member of key management personnel in common, it is necessary to consider the possibility, and to assess the likelihood, that this person would be able to affect the policies of both entities in their mutual dealings. However, the mere fact that there is a member of key management personnel in common does not necessarily create a related party relationship.

12. In the context of this Standard, the following are deemed not to be related parties:

    (a) (i) Providers of finance in the course of their business in that regard; and

(ii) Trade unions;

in the course of their normal dealings with an entity by virtue only of those dealings (although they may circumscribe the freedom of action of an entity or participate in its decision-making process); and

(b) An entity with which the relationship is solely that of an agency.

13. Related party relationships may arise when an individual is either a member of the governing body or is involved in the financial and operating decisions of the reporting entity. Related party relationships may also arise through external operating relationships between the reporting entity and the related party. Such relationships will often involve a degree of economic dependency.

14. Economic dependency, where one entity is dependent on another in that it relies on the latter for a significant volume of its funding or sale of its goods and services, would on its own be unlikely to lead to control or significant influence and is therefore unlikely to give rise to a related party relationship. As such, a single customer, supplier, franchisor, distributor, or general agent with whom a public sector entity transacts a significant volume of business will not be a related party merely by virtue of the resulting economic dependency. However, economic dependency, together with other factors, may give rise to significant influence and therefore a related party relationship. Judgment is required in assessing the impact of economic dependence on a relationship. Where the reporting entity is economically dependent on another entity, the reporting entity is encouraged to disclose the existence of that dependency.

15. The definition of related party includes entities owned by key management personnel, close family members of such individuals or major shareholders (or equivalent where the entity does not have a formal equity structure) of the reporting entity. The definition of related party also includes circumstances in which one party has the ability to exercise significant influence over the other party. In the public sector, an individual or entity may be given oversight responsibility for a reporting entity, which gives them significant influence, but not control, over the financial and operating decisions of the reporting entity. For the purposes of this Standard, significant influence is defined to encompass entities subject to joint control.

Remuneration of Key Management Personnel

16. Remuneration of key management personnel includes remuneration derived by individuals from the reporting entity for services provided to the reporting entity in their capacity as members of the governing body or employees. Benefits derived directly or indirectly from the entity for services in any capacity other than as an employee or a member of the governing body do not satisfy the definition of remuneration of key management personnel in this

Standard. However, paragraph 34 requires disclosures to be made about certain of these other benefits. Remuneration of key management personnel excludes any consideration provided solely as a reimbursement for expenditure incurred by those individuals for the benefit of the reporting entity, such as the reimbursement of accommodation costs associated with work-related travel.

Voting Power

17. The definition of related party will include any individuals owning, directly or indirectly, an interest in the voting power of the reporting entity that gives them significant influence over the entity. The holding of an interest in the voting power of an entity can arise when a public sector entity has a corporate structure and a minister or government agency holds shares in the entity.

The Related Party Issue

18. Related party relationships exist throughout the public sector, because:

    (a) Administrative units are subject to the overall direction of the executive government and, ultimately, the Parliament or similar body of elected or appointed officials, and operate together to achieve the policies of the government;

    (b) Government departments and agencies frequently conduct activities necessary for the achievement of different components of their responsibilities and objectives through separate controlled entities, and through entities over which they have significant influence; and

    (c) Ministers or other elected or appointed members of the government and senior management group can exert significant influence over the operations of a department or agency.

19. Disclosure of certain related party relationships and related party transactions and the relationship underlying those transactions is necessary for accountability purposes and enables users to better understand the financial statements of the reporting entity because:

    (a) Related party relationships can influence the way in which an entity operates with other entities in achieving its individual objectives, and the way in which it co-operates with other entities in achieving common or collective objectives;

    (b) Related party relationships might expose an entity to risks or provide opportunities that would not have existed in the absence of the relationship; and

    (c) Related parties may enter into transactions that unrelated parties would not enter into, or may agree to transactions on different terms and conditions than those that would normally be available to unrelated parties. This occurs frequently in government departments and agencies where goods and services are transferred between departments at less than full cost recovery as a part of normal operating procedures consistent with the achievement of the objectives of the reporting entity and the government. Governments and individual public sector entities are expected to use resources efficiently, effectively and in the manner intended, and to deal with public monies with the highest levels of integrity. The existence of related party relationships means that one party can control or significantly influence the activities of another party. This provides the opportunity for transactions to occur on a basis that may advantage one party inappropriately at the expense of another.

20. Disclosure of certain types of related party transactions that occur and the terms and conditions on which they were conducted allows users to assess the impact of those transactions on the financial position and performance of an entity and its ability to deliver agreed services. This disclosure also ensures that the entity is transparent about its dealings with related parties.

Remuneration of Key Management Personnel

21. Key management personnel hold positions of responsibility within an entity. They are responsible for the strategic direction and operational management of an entity and are entrusted with significant authority. Their salaries are often established by statute or an independent tribunal or other body independent of the reporting entity. However, their responsibilities may enable them to influence the benefits of office that flow to them or their related parties. This Standard requires certain disclosures to be made about the remuneration of key management personnel and close members of the family of key management personnel during the reporting period, loans made to them and the consideration provided to them for services they provide to the entity other than as a member of the governing body or an employee. The disclosures required by this Standard will ensure that appropriate minimum levels of transparency are applied to the remuneration of key management personnel and close members of the family of key management personnel.

Materiality

22. IPSAS 1, “Presentation of Financial Statements” requires the separate disclosure of material items. The materiality of an item is determined with reference to the nature or size of that item. When assessing the materiality of related party transactions, the nature of the relationship between the reporting entity and the related party and the nature of the transaction may mean that a transaction is material regardless of its size.

Disclosure

23. In many countries, the laws, and other authoritative financial reporting rules, require financial statements of private sector entities and government business enterprises to disclose information about certain categories of related parties and related party transactions. In particular, attention is focused on the entity's transactions with its directors or members of its governing body and with its senior management group, especially their remuneration and borrowings. This is because of the fiduciary responsibilities of directors, members of the governing body and senior management group, and because they have extensive powers over the deployment of entity resources. In some jurisdictions, similar requirements are included in the statutes and regulations applicable to public sector entities.

24. Some IPSASs also require disclosure of transactions with related parties. For example, IPSAS 1 requires disclosure of amounts payable to and receivable from controlling entities, fellow controlled entities, associates and other related parties. IPSAS 6, "Consolidated and Separate Financial Statements" and IPSAS 7 require disclosure of a list of significant controlled entities and associates. IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" requires disclosure of extraordinary items and items of revenue and expense within surplus or deficit from ordinary activities that are of such size, nature or incidence that their disclosure is relevant to explain the performance of the entity for the period.

Disclosure of Control

25. **Related party relationships where control exists should be disclosed irrespective of whether there have been transactions between the related parties.**

26. In order for a reader of financial statements to form a view about the effects of related party relationships on a reporting entity, it is appropriate to disclose related party relationships where control exists, irrespective of whether there have been transactions between the related parties. This would involve the disclosure of the names of any controlled entities, the name of the immediate controlling entity and the name of the ultimate controlling entity, if any.

Disclosure of Related Party Transactions

27. **In respect of transactions between related parties other than transactions that would occur within a normal supplier or client/recipient relationship on terms and conditions no more or less favorable than those which it is reasonable to expect the entity would have adopted if dealing with that individual or entity at arm's length in the same circumstances, the reporting entity should disclose:**

(a) **The nature of the related party relationships;**

(b) **The types of transactions that have occurred; and**

(c) The elements of the transactions necessary to clarify the significance of these transactions to its operations and sufficient to enable the financial statements to provide relevant and reliable information for decision making and accountability purposes.

28. The following are examples of situations where related party transactions may lead to disclosures by a reporting entity:

(a) Rendering or receiving of services;

(b) Purchases or transfers/sales of goods (finished or unfinished);

(c) Purchases or transfers/sales of property and other assets;

(d) Agency arrangements;

(e) Leasing arrangements;

(f) Transfer of research and development;

(g) License agreements;

(h) Finance (including loans, capital contributions, grants whether in cash or in kind and other financial support including cost sharing arrangements); and

(i) Guarantees and collaterals.

29. Public sector entities transact extensively with each other on a daily basis. These transactions may occur at cost, less than cost or free-of-charge. For example, a government department of administrative services may provide office accommodation free of charge to other departments, or a public sector entity may act as a purchasing agent for other public sector entities. In some models of government there may be the capacity for recovery of more than the full cost of service delivery. Departments are related parties because they are subject to common control and these transactions meet the definition of related party transactions. However, disclosure of information about transactions between these entities is not required where the transactions are consistent with normal operating relationships between the entities, and are undertaken on terms and conditions that are normal for such transactions in these circumstances. The exclusion of these related party transactions from the disclosure requirements of paragraph 27 reflects that public sector entities operate together to achieve common objectives, and acknowledges that different mechanisms may be adopted for the delivery of services by public sector entities in different jurisdictions. This Standard requires disclosures of related party transactions only when those

transactions occur other than in accordance with the operating parameters established in that jurisdiction.

30. The information about related party transactions that would need to be disclosed to meet the objectives of general purpose financial reporting would normally include:

    (a) A description of the nature of the relationship with related parties involved in these transactions. For example, whether the relationship was one of a controlling entity, a controlled entity, an entity under common control, or key management personnel;

    (b) A description of the related party transactions within each broad class of transaction and an indication of the volume of the classes, either as a specific monetary amount or as a proportion of that class of transactions and/or balances;

    (c) A summary of the broad terms and conditions of transactions with related parties, including disclosure of how these terms and conditions differ from those normally associated with similar transactions with unrelated parties; and

    (d) Amounts or appropriate proportions of outstanding items.

31. Paragraph 34 of this Standard requires additional disclosures to be made about certain transactions between an entity and key management personnel and/or the close members of the family of key management personnel.

32. **Items of a similar nature may be disclosed in aggregate except when separate disclosure is necessary to provide relevant and reliable information for decision making and accountability purposes.**

33. Disclosure of related party transactions between members of an economic entity is unnecessary in consolidated financial statements because consolidated financial statements present information about the controlling entity and controlled entities as a single reporting entity. Related party transactions that occur between entities within an economic entity are eliminated on consolidation in accordance with IPSAS 6. Transactions with associated entities accounted for under the equity method are not eliminated and therefore require separate disclosure as related party transactions.

Disclosure — Key Management Personnel

34. **An entity shall disclose:**

    (a) **The aggregate remuneration of key management personnel and the number of individuals, determined on a full time equivalent basis, receiving remuneration within this category, showing separately major classes of key management personnel and including a description of each class;**

(b) **The total amount of all other remuneration and compensation provided to key management personnel, and close members of the family of key management personnel, by the reporting entity during the reporting period showing separately the aggregate amounts provided to:**

(i) **Key management personnel; and**

(ii) **Close members of the family of key management personnel; and**

(c) **In respect of loans which are not widely available to persons who are not key management personnel and loans whose availability is not widely known by members of the public, for each individual member of key management personnel and each close member of the family of key management personnel:**

(i) **The amount of loans advanced during the period and terms and conditions thereof;**

(ii) **The amount of loans repaid during the period;**

(iii) **The amount of the closing balance of all loans and receivables; and**

(iv) **Where the individual is not a director or member of the governing body or senior management group of the entity, the relationship of the individual to such.**

35. Paragraph 27 of this Standard requires the disclosure of related party transactions which have occurred other than on an arm’s length basis consistent with the operating conditions established for the entity. This Standard also requires the disclosure of information about certain transactions with key management personnel identified in paragraph 34, whether or not they have occurred on an arm’s length basis consistent with the operating conditions that apply in respect of the entity.

36. Persons who are key management personnel may be employed on a full or part time basis. The number of individuals disclosed as receiving remuneration in accordance with paragraph 34(a) needs to be estimated on a full time equivalent basis. Entities will make separate disclosures about the major classes of key management personnel that they have. For example, where an entity has a governing body that is separate from its senior management group, disclosures about remuneration of the two groups will be made separately. Where an individual is a member of both the governing body and the senior management group, that individual will be included in only one of those groups for the purposes of this Standard. The categories of key management personnel identified in the definition of key

management personnel provide a guide to identifying classes of key management personnel.

37. Remuneration of key management personnel can include a variety of direct and indirect benefits. Where the cost of these benefits is determinable, that cost will be included in the aggregate remuneration disclosed. Where the cost of these benefits is not determinable, a best estimate of the cost to the reporting entity or entities will be made and included in the aggregate remuneration disclosed.

38. Requirements on the measurement of employee benefits are found in IPSAS 25, "Employee Benefits." When non-monetary remuneration that is able to be reliably measured has been included in the aggregate amount of remuneration of key management personnel disclosed for the period, disclosure would also be made in the notes to the financial statements of the basis of measurement of the non-monetary remuneration.

39. This Standard requires the disclosure of certain information about the terms and conditions of loans made to key management personnel and close members of the family of key management personnel, where these loans:

(a) Are not widely available to persons outside the key management group; and

(b) May be widely available outside the key management group but whose availability is not widely known to members of the public.

The disclosure of this information is required for accountability purposes. The exercise of judgment may be necessary in determining which loans should be disclosed to satisfy the requirements of this Standard. That judgment should be exercised after consideration of the relevant facts and in a manner consistent with the achievement of the objectives of financial reporting.

40. Paragraph 34(a) of this Standard requires disclosure of the aggregate remuneration of key management personnel. Key management personnel include directors or members of the governing body and members of the senior management group of the entity. Directors or members of the governing body of the entity may also receive remuneration or compensation from the entity for services provided in a capacity other than as director or member of the governing body of the entity or as an employee of the entity. Paragraph 34(b)(i) of this Standard requires the disclosure of the total amount of this other remuneration or compensation.

41. Close members of the family of key management personnel may influence, or be influenced by, key management personnel in their transactions with the reporting entity. Paragraph 34(b)(ii) of this Standard requires the disclosure of the total remuneration and compensation provided during the period to close members of the family of key management personnel.

Effective Date

42. **This IPSAS becomes effective for annual financial statements covering periods beginning on or after January 1, 2004. Earlier application is encouraged.**

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

Appendix

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

Disclosures — Government X

The following disclosures are made in the financial statements of Government X.

Controlled Entities (Paragraph 25)

The Government controls the following reporting entities:

Government Departments and Agencies: Education, Welfare, Police, Post, Works and Services, Defense, Justice, Treasury/Finance, Department X, Agency XYZ (identify all departments and agencies).

Government Business Enterprises: Government Electricity Company, Government Telecommunications Agency (identify all GBEs).

(Note: IPSAS 6, "Consolidated and Separate Financial Statements" requires that certain disclosures be made about significant controlled entities.)

Related Party Transactions (Paragraph 27)

A member of Cabinet was provided with a house, rent free, in the national Capital City. Houses similar to that provided to the Minister rent for approximately Z currency units per annum. The provision of accommodation is not part of the remuneration package of the Minister and the Government does not generally provide free accommodation to ministers. However, in this case it was necessary to provide a residence for the Minister in the Capital City.

The partner of another member of Cabinet was provided with a motor vehicle, rent free. Cars similar to that provided normally rent for K currency units per annum. The government does not generally provide motor vehicles, rent free, to the domestic partners of ministers.

Key Management Personnel (Paragraph 34)

Remuneration (Paragraph 34(a))

The key management personnel (as defined by IPSAS 20, "Related Party Disclosures") are the members of Cabinet, who together constitute the governing body of Government X. The aggregate remuneration of members of the Cabinet and the number of individuals determined on a full-time equivalent basis receiving remuneration from Government X are:

Aggregate remuneration	X million.
Number of persons	Y persons.

Loans which are not widely available (and/or widely known) to persons outside the key management group (Paragraph 34(c))

Amounts of such loans advanced and repaid during the period, and the balances outstanding at the end of the period are outlined below:

Individual	Advanced	Repaid	Balance
The Honorable ABC	J	K	L
Ms. VSL	M	N	P
The Honorable D	Q	R	Z
The Honorable E	S	T	U

Terms and Conditions

The Honorable ABC, Minister of Transport, received a loan at X% per annum, which is Y% below the market rate. The term of the loan is for Z years.

Ms. VSL, partner of the Minister of Health, received a government loan. The loan is for N years at X% per annum, the current government borrowing rate.

The salary packages of Cabinet Ministers the Honorable D and E allow them to take out a government loan for up to A years at Y% per annum to purchase a car.

Other remuneration and compensation provided to key management personnel and their close family members (Paragraph 34(b))

During the reporting period total compensation of X amount (currency units) was provided to members of the Cabinet for consulting services provided to particular government agencies.

During the reporting period the government provided total remuneration and compensation of Y amount (currency units) to close family members of key management personnel. This amount consists of the remuneration of government employees who are close members of the family of members of the Cabinet.

Disclosure—Government Agency XYZ

These disclosures are made in the financial statements of Government Agency XYZ, which is a separate reporting entity.

Controlled Entities (Paragraph 25)

The Agency is controlled by Department X. Department X is controlled by Government X.

The Agency controls the Administration Services Unit which is a government business enterprise (GBE).

(Note: IPSAS 6, "Consolidated and Separate Financial Statements" requires that certain disclosures be made about significant controlled entities.)

Related Party Transactions (Paragraph 27)

The Agency provided a house, rent free, to the Minister. Houses similar to that provided to the Minister rent for approximately Z currency units per annum. The house is not part of the remuneration package of the Minister and, as a matter of operating procedure, government agencies do not provide residential accommodation to ministers. However, Government X advised that the house should be provided on this occasion.

Key Management Personnel (Paragraph 34)

Remuneration (Paragraph 34(a))

The key management personnel (as defined by IPSAS 20) of Agency XYZ are: the Minister, the members of the governing body and the members of the senior management group. The governing body consists of members appointed by Government X; the chief executive officer and the chief financial officer attend meetings of the governing body but are not members of the governing body. The Minister is not remunerated by Agency XYZ. The aggregate remuneration of members of the governing body and the number of members determined on a full time equivalent basis receiving remuneration within this category, are:

Aggregate remuneration	AX million.
Number of persons	AY persons.

The senior management group consists of the Agency's chief executive officer, the chief financial officer, and the AZ heads of division. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category are:

Aggregate remuneration	AP million.
Number of persons	AQ persons.

Two division heads are on secondment from Department X and are remunerated by Department X.

Loans which are not widely available (and/or widely known) to persons outside the key management group (Paragraph 34(c))

Amounts advanced and repaid during the period and balance outstanding at the end of the period:

Individual	Advanced	Repaid	Balance
The Minister	J	K	L
Mr. G	M	N	P
Ms. H	Q	R	Z

Terms and conditions

The Minister received a loan of J currency units, at X% per annum, which is Y% below the market rate. The term of the loan is for Z years.

The salary package of senior staff members Mr. G and Ms. H allows them to take out a government loan for up to N years at Y% per annum to purchase a car.

Remuneration and compensation provided to close family members of key management personnel (Paragraph 34(b))

During the reporting period total remuneration and compensation of F amount (currency units) was provided by the Agency to employees who are close family members of key management personnel.

Comparison with IAS 24

IPSAS 20, "Related Party Disclosures" is drawn primarily from IAS 24 (reformatted 1994), "Related Party Disclosures." The main differences between IPSAS 20 and IAS 24 are as follows:

- The structure of IPSAS 20 differs substantially from that of IAS 24.
- The exclusion from the scope of IAS 24 of wholly-owned subsidiaries where the parent entity is domiciled in the same country and provides consolidated financial statements in that country has not been adopted in IPSAS 20.
- Commentary which identifies key management personnel in IAS 24 has been included in a formal definition of key management personnel in IPSAS 20. The commentary in IAS 24 includes close members of the family, the definition of key management personnel in IPSAS 20 does not include close members of the family.
- The definition of related party in IPSAS 20 includes related party relationships which are only noted in commentary in IAS 24.
- IPSAS 20 includes a definition of remuneration of key management personnel. IAS 24 does not include this definition.
- IPSAS 20 contains additional disclosure requirements in relation to the remuneration of key management personnel and their close family members and certain other transactions between an entity and its key management personnel and their close family members.
- Commentary additional to that in IAS 24 has been included in IPSAS 20 to clarify the applicability of the standards to accounting by public sector entities.
- Except for limited disclosures about the remuneration of, and certain other specified transactions with, key management personnel, IPSAS 20 does not require the disclosure of information about transactions between related parties which occur on normal terms and conditions. IAS 24 has more limited exclusions for related party transactions which occur in the course of normal dealings between the parties.
- IPSAS 20 uses different terminology, in certain instances, from IAS 24. The most significant examples are the use of the terms entity and members of the governing body in IPSAS 20. The equivalent terms in IAS 24 are enterprise and directors.

IPSAS 21—IMPAIRMENT OF NON-CASH-GENERATING ASSETS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) deals with the impairment of non-cash-generating assets in the public sector. This Standard is drawn primarily from IAS 36, which was published by the International Accounting Standards Board (IASB). Extracts from International Accounting Standard IAS 36 (2004), "Impairment of Assets" are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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Objective

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

Scope

2. **An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for impairment of non-cash-generating assets, except:**

   (a) **Inventories (see IPSAS 12, "Inventories");**

   (b) **Assets arising from construction contracts (see IPSAS 11, "Construction Contracts");**

   (c) **Financial assets that are included in the scope of IPSAS 15, "Financial Instruments: Disclosure and Presentation";**

   (d) **Investment property that is measured using the fair value model (see IPSAS 16, "Investment Property");**

   (e) **Non-cash-generating property, plant and equipment that is measured at revalued amounts (see IPSAS 17, "Property, Plant and Equipment"); and**

   (f) **Other assets in respect of which accounting requirements for impairment are included in another International Public Sector Accounting Standard.**

3. **This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).**

4. **Public sector entities that hold cash-generating assets as defined in paragraph 14 shall apply IPSAS 26, "Impairment of Cash-Generating Assets" to such assets. Public sector entities that hold non-cash-generating assets shall apply the requirements of this Standard to non-cash-generating assets.**

5. This Standard excludes from its scope the impairment of assets that are dealt with in another IPSAS. GBEs apply International Accounting Standard (IAS) 36 and therefore are not subject to the provisions of this Standard. Public sector entities other than GBEs apply IPSAS 26, "Impairment of Cash-Generating Assets" to their cash-generating assets and apply this Standard to their non-cash-generating assets. Paragraphs 6–13 explain the scope of the Standard in greater detail.

6. This Standard includes non-cash-generating intangible assets within its scope. Entities apply the requirements of this Standard to recognizing and

measuring impairment losses, and reversals of impairment losses, related to non-cash-generating intangible assets.

7. This Standard does not apply to inventories and assets arising from construction contracts because existing IPSASs applicable to these assets contain requirements for recognizing and measuring these assets.

8. This Standard does not apply to financial assets that are included in the scope of IPSAS 15. Impairment of these assets will be dealt with in any IPSAS that the IPSASB develops on the basis of IAS 39, "Financial Instruments: Recognition and Measurement" to deal with the recognition and measurement of financial instruments.

9. This Standard does not require the application of an impairment test to an investment property that is carried at fair value in accordance with IPSAS 16. This is because under the fair value model in IPSAS 16, an investment property is carried at fair value at the reporting date and any impairment will be taken into account in the valuation.

10. This Standard does not require the application of an impairment test to non-cash-generating assets that are carried at revalued amounts under the allowed alternative treatment in IPSAS 17. This is because under the allowed alternative treatment in IPSAS 17, assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date and any impairment will be taken into account in the valuation. In addition, the approach adopted in this Standard to measuring an asset's recoverable service amount means that it is unlikely that the recoverable service amount of an asset will be materially less than an asset's revalued amount and that any such differences would relate to the costs of disposal of the asset.

11. Consistent with the requirements of paragraph 4 above, items of property, plant and equipment that are classified as cash-generating assets including those that are carried at revalued amounts under the allowed alternative treatment in IPSAS 17, are dealt with under IAS 36.

12. Investments in:

    (a) Controlled entities, as defined in IPSAS 6, "Consolidated and Separate Financial Statements;"

    (b) Associates, as defined in IPSAS 7, "Accounting for Investments in Associates;" and

    (c) Joint ventures, as defined in IPSAS 8, "Interests in Joint Ventures;"

    are financial assets that are excluded from the scope of IPSAS 15. Where such investments are classified as cash-generating assets, they are dealt with under IPSAS 26, "Impairment of Cash Generating Assets." Where these assets are non-cash-generating assets, they are dealt with under this Standard.

13. The "Preface to International Financial Reporting Standards" issued by the International Accounting Standards Board (IASB) explains that International Financial Reporting Standards (IFRSs) are designed to apply to the general purpose financial statements of all profit-oriented entities. GBEs are defined in paragraph 14 below. They are profit-oriented entities. Accordingly, they are required to comply with IFRSs.

Definitions

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

An <u>active market</u> is a market in which all the following conditions exist:

(a) **The items traded within the market are homogeneous;**

(b) **Willing buyers and sellers can normally be found at any time; and**

(c) **Prices are available to the public.**

<u>Carrying amount</u> is the amount at which an asset is recognized in the statement of financial position after deducting any accumulated depreciation and accumulated impairment losses thereon.

<u>Cash-generating assets</u> are assets held with the primary objective of generating a commercial return.

<u>Costs of disposal</u> are incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.

<u>Depreciation (Amortization)</u> is the systematic allocation of the depreciable amount of an asset over its useful life.

<u>Fair value less costs to sell</u> is the amount obtainable from the sale of an asset in an arm's length transaction between knowledgeable, willing parties, less the costs of disposal.

<u>Government Business Enterprise</u> means an entity that has all the following characteristics:

(a) **Is an entity with the power to contract in its own name;**

(b) **Has been assigned the financial and operational authority to carry on a business;**

(c) **Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;**

(d) **Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and**

(e) **Is controlled by a public sector entity.**

An impairment is a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.

An impairment loss of a non-cash-generating asset is the amount by which the carrying amount of an asset exceeds its recoverable service amount.

Non-cash-generating assets are assets other than cash-generating assets.

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

Useful life is either:

(a) **The period of time over which an asset is expected to be used by the entity; or**

(b) **The number of production or similar units expected to be obtained from the asset by the entity.**

Value in use of a non-cash-generating asset is the present value of the asset's remaining service potential.

Government Business Enterprises

15. GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge.

Cash-Generating Assets

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

an asset or assets in the following paragraphs of this Standard are references to non-cash-generating asset(s).

17. There are a number of circumstances in which public sector entities may hold some assets with the primary objective of generating a commercial return, although the majority of assets are not held for that purpose. For example, a hospital may deploy a building for fee-paying patients. Cash-generating assets of a public sector entity may operate independently of the non-cash-generating assets of the entity. For example, the deeds office may earn land registration fees independently from the department of land affairs.

18. In certain instances, an asset may generate cash flows although it is primarily held for service delivery purposes. For example, a waste disposal plant is operated to ensure the safe disposal of medical waste generated by state controlled hospitals, but the plant also treats a small amount of medical waste generated by other private hospitals on a commercial basis. The treatment of medical waste from the private hospitals is incidental to the activities of the plant, and the assets that generate cash flows cannot be distinguished from the non-cash-generating assets.

19. In other instances, an asset may generate cash flows and also be used for non-cash-generating purposes. For example, a public hospital has ten wards, nine of which are used for feepaying patients on a commercial basis, and the other is used for non-fee paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 26. If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies IPSAS 26 rather than this Standard.

20. In some cases it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases it is necessary to evaluate the significance of the cash flows. It may be difficult to determine whether the extent to which the asset generates cash flows is so significant that this Standard is applicable rather than IPSAS 26. Judgment is needed to determine which Standard to apply. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets and with the related guidance in paragraphs 16–20. Paragraph 72 requires an entity to disclose the criteria used in making this judgment. However, given the overall objectives of most public sector entities, other than GBEs, the presumption is that assets are non-cash-generating and, therefore, IPSAS 21 will apply.

21. Assets held by GBEs are cash-generating assets. Public sector entities other than GBEs may hold assets to generate a commercial return. For the purposes of this Standard, an asset held by a non-GBE public sector entity

is classified as a cash-generating asset if the asset (or unit of which the asset is a part) is operated with the objective of generating a commercial return through the provision of goods and/or services to external parties.

Depreciation

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

Impairment

23. This Standard defines an impairment as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation (amortization). Impairment, therefore, reflects a decline in the utility of an asset to the entity that controls it. For example, an entity may have a purpose-built military storage facility that it no longer uses. In addition, because of the specialized nature of the facility and its location, it is unlikely that it can be leased out or sold and therefore the entity is unable to generate cash flows from leasing or disposing of the asset. The asset is regarded as impaired as it is no longer capable of providing the entity with service potential – it has little, or no, utility for the entity in contributing to the achievement of its objectives.

Identifying an Asset that may be Impaired

24. Paragraphs 26–34 specify when recoverable service amount would be determined.

25. A non-cash-generating asset is impaired when the carrying amount of the asset exceeds its recoverable service amount. Paragraph 27 identifies key indications that an impairment loss may have occurred. If any of those indications are present, an entity is required to make a formal estimate of recoverable service amount. If no indication of a potential impairment loss is present, this Standard does not require an entity to make a formal estimate of recoverable service amount.

26. **An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable service amount of the asset.**

27. **In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications:**

External sources of information

(a) **Cessation, or near cessation, of the demand or need for services provided by the asset;**

(b) **Significant long-term changes with an adverse effect on the entity have taken place during the period or will take place in the near future, in the technological, legal or government policy environment in which the entity operates;**

Internal sources of information

(c) **Evidence is available of physical damage of an asset;**

(d) **Significant long-term changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, an asset is used or is expected to be used. These changes include the asset becoming idle, plans to discontinue or restructure the operation to which an asset belongs, or plans to dispose of an asset before the previously expected date;**

(e) **A decision to halt the construction of the asset before it is complete or in a usable condition; and**

(f) **Evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, significantly worse than expected.**

28. The demand or need for services may fluctuate over time, which will affect the extent to which non-cash-generating assets are utilized in providing those services, but negative fluctuations in demand are not necessarily indications of impairment. Where demand for services ceases, or nearly ceases, the assets used to provide those services may be impaired. Demand may be considered to have nearly ceased when it is so low that the entity would not have attempted to respond to that demand, or would have responded by not acquiring the asset being considered for impairment testing.

29. The list in paragraph 27 is not exhaustive. There may be other indications that an asset may be impaired. The existence of other indications may result in the entity estimating the asset's recoverable service amount. For example, any of the following may be an indication of impairment:

(a) During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use; or

(b) A significant long-term decline (but not necessarily cessation or near cessation) in the demand for or need for services provided by the asset.

30. The events or circumstances that may indicate an impairment of an asset will be significant and will often have prompted discussion by the governing board, management, or media. A change in a parameter such as demand for the service, extent or manner of use, legal environment or government policy environment would indicate impairment only if such a change was significant and had or was anticipated to have a long-term adverse effect. A change in the technological environment may indicate that an asset is obsolete, and requires testing for impairment. A change in the use of an asset during the period may also be an indication of impairment. This may occur when, for example, a building used as a school undergoes a change in use and is used for storage. In assessing whether an impairment has occurred, the entity needs to assess changes in service potential over the long term. This underlines the fact that the changes are seen within the context of the anticipated long-term use of the asset. However, the expectations of long-term use can change and the entity's assessments at each reporting date would reflect that. Appendix A sets out examples of impairment indications referred to in paragraph 27.

31. In assessing whether a halt in construction would trigger an impairment test, the entity would consider whether construction has simply been delayed or postponed, whether there is an intention to resume construction in the near future, or whether the construction work will not be completed in the foreseeable future. Where construction is delayed or postponed to a specific future date, the project may be treated as work in progress and is not considered as halted.

32. Evidence from internal reporting that indicates that an asset may be impaired, as referred to in paragraph 27(f) above, relates to the ability of the asset to provide goods or services rather than to a decline in the demand for the goods or services provided by the asset. This includes the existence of:

    (a) Significantly higher costs of operating or maintaining the asset, compared with those originally budgeted; and

    (b) Significantly lower service or output levels provided by the asset compared with those originally expected due to poor operating performance.

    A significant increase in operating costs of an asset may indicate that the asset is not as efficient or productive as initially anticipated in output standards set by the manufacturer, in accordance with which the operating budget was drawn up. Similarly, a significant increase in maintenance costs may indicate that higher costs need to be incurred to maintain the asset's performance at a level indicated by its most recently assessed standard of performance. In other cases, direct quantitative evidence of an impairment may be indicated by a significant long-term fall in the expected service or output levels provided by the asset.

33. The concept of materiality applies in identifying whether the recoverable service amount of an asset needs to be estimated. For example, if previous assessments show that an asset's recoverable service amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable service amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable service amount is not sensitive to one (or more) of the indications listed in paragraph 27.

34. If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortization) method or the residual value for the asset need to be reviewed and adjusted in accordance with the IPSAS applicable to the asset, even if no impairment loss is recognized for the asset.

Measuring Recoverable Service Amount

35. This Standard defines recoverable service amount as the higher of an asset's fair value less costs to sell and its value in use. Paragraphs 36–50 set out the basis for measuring recoverable service amount.

36. It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

37. It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. Paragraph 42 sets out possible alternative bases for estimating fair value less costs to sell when an active market for the asset does not exist. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value in use as its recoverable service amount.

38. If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable service amount. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds. However, for many public sector non-cash-generating assets which are held on an ongoing basis to provide specialized services or public goods to the community, the value in use of the asset is likely to be greater than its fair value less costs to sell.

39. In some cases, estimates, averages and computational short cuts may provide reasonable approximations of the detailed computations illustrated in this Standard for determining fair value less costs to sell or value in use.

Fair Value Less Costs to Sell

40. The best evidence of an asset's fair value less costs to sell is a price in a binding sale agreement in an arm's length transaction, adjusted for incremental costs that would be directly attributable to the disposal of the asset.

41. If there is no binding sale agreement but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, provided that there has not been a significant change in economic circumstances between the transaction date and the date as at which the estimate is made.

42. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity could consider the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale, unless management or the governing body is compelled to sell immediately.

43. Costs of disposal, other than those that have been recognized as liabilities, are deducted in determining fair value less costs to sell. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits (as defined in IPSAS 25, "Employee Benefits") and costs associated with reducing or reorganizing a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

Value in Use

44. This Standard defines the value in use of a non-cash-generating asset as the present value of the asset's remaining service potential. Value in use in this Standard refers to value in use of a non-cash-generating asset unless otherwise specified. The present value of the remaining service potential of the asset is determined using any one of the approaches identified in paragraphs 45–49, as appropriate.

Depreciated Replacement Cost Approach

45. Under this approach, the present value of the remaining service potential of an asset is determined as the depreciated replacement cost of the asset. The replacement cost of an asset is the cost to replace the asset's gross service potential. This cost is depreciated to reflect the asset in its used condition. An asset may be replaced either through reproduction (replication) of the

existing asset or through replacement of its gross service potential. The depreciated replacement cost is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost, to reflect the already consumed or expired service potential of the asset.

46. The replacement cost and reproduction cost of an asset are determined on an optimized basis. The rationale is that the entity would not replace or reproduce the asset with a like asset if the asset to be replaced or reproduced is an overdesigned or overcapacity asset. Overdesigned assets contain features which are unnecessary for the goods or services the asset provides. Overcapacity assets are assets that have a greater capacity than is necessary to meet the demand for goods or services the asset provides. The determination of the replacement cost or reproduction cost of an asset on an optimized basis thus reflects the service potential required of the asset.

47. In certain cases, standby or surplus capacity is held for safety or other reasons. This arises from the need to ensure that adequate service capacity is available in the particular circumstances of the entity. For example, the fire department needs to have fire engines on standby to deliver services in emergencies. Such surplus or standby capacity is part of the required service potential of the asset.

Restoration Cost Approach

48. Restoration cost is the cost of restoring the service potential of an asset to its pre-impaired level. Under this approach, the present value of the remaining service potential of the asset is determined by subtracting the estimated restoration cost of the asset from the current cost of replacing the remaining service potential of the asset before impairment. The latter cost is usually determined as the depreciated reproduction or replacement cost of the asset whichever is lower. Paragraphs 45 and 47 include additional guidance on determining the replacement cost or reproduction cost of an asset.

Service Units Approach

49. Under this approach, the present value of the remaining service potential of the asset is determined by reducing the current cost of the remaining service potential of the asset before impairment to conform with the reduced number of service units expected from the asset in its impaired state. As in the restoration cost approach, the current cost of replacing the remaining service potential of the asset before impairment is usually determined as the depreciated reproduction or replacement cost of the asset before impairment, whichever is lower.

Application of Approaches

50. The choice of the most appropriate approach to measuring value in use depends on the availability of data and the nature of the impairment:

    (a) Impairments identified from significant long-term changes in the technological, legal or government policy environment are generally measurable using a depreciated replacement cost approach or a service units approach, when appropriate;

    (b) Impairments identified from a significant long-term change in the extent or manner of use, including that identified from the cessation or near cessation of demand, are generally measurable using a depreciated replacement cost or a service units approach when appropriate; and

    (c) Impairments identified from physical damage are generally measurable using a restoration cost approach or a depreciated replacement cost approach when appropriate.

Recognizing and Measuring an Impairment Loss

51. Paragraphs 52–57 set out the requirements for recognizing and measuring impairment losses for an asset. In this Standard impairment loss refers to impairment loss of a non-cash-generating asset unless otherwise specified.

52. **If, and only if, the recoverable service amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable service amount. That reduction is an impairment loss.**

53. As noted in paragraph 26, this Standard requires an entity to make a formal estimate of recoverable service amount only if an indication of a potential impairment loss is present. Paragraphs 27–33 identify key indications that an impairment loss may have occurred.

54. **An impairment loss shall be recognized immediately in surplus or deficit.**

55. **When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognize a liability if, and only if, that is required by another IPSAS.**

56. Where the estimated impairment loss is greater than the carrying amount of the asset, the carrying amount of the asset is reduced to zero with a corresponding amount recognized in surplus or deficit. A liability would be recognized only if another IPSAS so requires. An example is when a purpose built military installation is no longer used and the entity is required by law to remove such installations if not usable. The entity may need to make a provision for dismantling costs if required by IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets."

57. **After the recognition of an impairment loss, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Reversing an Impairment Loss

58. Paragraphs 59–70 set out the requirements for reversing an impairment loss recognized for an asset in prior periods.

59. **An entity shall assess at each reporting date whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable service amount of that asset.**

60. **In assessing whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:**

External sources of information

(a) **Resurgence of the demand or need for services provided by the asset.**

(b) **Significant long-term changes with a favorable effect on the entity have taken place during the period, or will take place in the near future, in the technological, legal or government policy environment in which the entity operates.**

Internal sources of information

(c) **Significant long-term changes with a favorable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance an asset's performance or restructure the operation to which the asset belongs.**

(d) **A decision to resume construction of the asset that was previously halted before it was completed or in a usable condition.**

(e) **Evidence is available from internal reporting that indicates that the service performance of the asset is, or will be, significantly better than expected.**

61. Indications of a potential decrease in an impairment loss in paragraph 60 mainly mirror the indications of a potential impairment loss in paragraph 27.

62. The list in paragraph 60 is not exhaustive. An entity may identify other indications of a reversal of an impairment loss that would also require the entity to re-estimate the asset's recoverable service amount. For example, any of the following may be an indication that the impairment loss may have reversed:

    (a) A significant rise in an asset's market value; or

    (b) A significant long-term increase in the demand or need for the services provided by the asset.

63. A commitment to discontinue or restructure an operation in the near future is an indication of a reversal of an impairment loss of an asset belonging to the operation where such a commitment constitutes a significant long-term change, with a favorable effect on the entity, in the extent or manner of use of that asset. Circumstances where such a commitment would be an indication of reversal of impairment often relate to cases where the expected discontinuance or restructuring of the operation would create opportunities to enhance the utilization of the asset. An example is an x-ray machine that has been underutilized by a clinic managed by a public hospital and, as a result of restructuring, is expected to be transferred to the main radiology department of the hospital where it will have significantly better utilization. In such a case, the commitment to discontinue or restructure the clinic's operation may be an indication that an impairment loss recognized for the asset in prior periods may have to be reversed.

64. If there is an indication that an impairment loss recognized for an asset may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortization) method or the residual value may need to be reviewed and adjusted in accordance with the IPSAS applicable to the asset, even if no impairment loss is reversed for the asset.

65. **An impairment loss recognized in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable service amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset shall, except as described in paragraph 68, be increased to its recoverable service amount. That increase is a reversal of an impairment loss.**

66. This Standard requires an entity to make a formal estimate of recoverable service amount only if an indication of a reversal of an impairment loss is present. Paragraph 60 identifies key indications that an impairment loss

recognized for an asset in prior periods may no longer exist or may have decreased.

67. A reversal of an impairment loss reflects an increase in the estimated recoverable service amount of an asset, either from use or from sale, since the date when an entity last recognized an impairment loss for that asset. Paragraph 77 requires an entity to identify the change in estimates that causes the increase in recoverable service amount. Examples of changes in estimates include:

(a) A change in the basis for recoverable service amount (i.e., whether recoverable service amount is based on fair value less costs to sell or value in use);

(b) If recoverable service amount was based on value in use, a change in estimate of the components of value in use; or

(c) If recoverable service amount was based on fair value less costs to sell, a change in estimate of the components of fair value less costs to sell.

68. **The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of depreciation or amortization) had no impairment loss been recognized for the asset in prior periods.**

69. **A reversal of an impairment loss for an asset shall be recognized immediately in surplus or deficit.**

70. **After a reversal of an impairment loss is recognized, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Redesignation of Assets

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

72. There are circumstances in which public sector entities may decide that it is appropriate to redesignate a non-cash-generating asset as a cash-generating asset. For example, an effluent treatment plant was constructed primarily to treat industrial effluent from a social housing unit, for which no charge is

made. The social housing unit has been demolished and the site will be developed for industrial and retail purposes. It is intended that, in future, the plant will be used to treat industrial effluent at commercial rates. In light of this decision the public sector entity decides to redesignate the effluent treatment plant as a cash-generating asset.

Disclosure

73. **An entity shall disclose the following for each class of assets:**

    (a) **The amount of impairment losses recognized in surplus or deficit during the period and the line item(s) of the statement of financial performance in which those impairment losses are included.**

    (b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period and the line item(s) of the statement of financial performance in which those impairment losses are reversed.**

74. A class of assets is a grouping of assets of similar nature and use in an entity's operations.

75. The information required in paragraph 73 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period, as required by IPSAS 17.

76. **An entity that reports segment information in accordance with IPSAS 18, "Segment Reporting" shall disclose the following for each segment reported by the entity:**

    (a) **The amount of impairment losses recognized in surplus or deficit during the period.**

    (b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period.**

77. **An entity shall disclose the following for each material impairment loss recognized or reversed during the period:**

    (a) **The events and circumstances that led to the recognition or reversal of the impairment loss.**

    (b) **The amount of the impairment loss recognized or reversed.**

    (c) **The nature of the asset.**

    (d) **The segment to which the asset belongs, if the entity reports segment information in accordance with IPSAS 18.**

(e) **Whether the recoverable service amount of the asset is its fair value less costs to sell or its value in use.**

(f) **If the recoverable service amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market).**

(g) **If the recoverable service amount is value in use, the approach used to determine value in use.**

78. **An entity shall disclose the following information for the aggregate of impairment losses and aggregate reversals of impairment losses recognized during the period for which no information is disclosed in accordance with paragraph 77:**

(a) **The main classes of assets affected by impairment losses (and the main classes of assets affected by reversals of impairment losses).**

(b) **The main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.**

79. An entity is encouraged to disclose key assumptions used to determine the recoverable service amount of assets during the period.

Transitional Provisions

80. **This Standard shall be applied prospectively from the date of its application. Impairment losses (reversals of impairment losses) that result from adoption of this IPSAS shall be recognized in accordance with this Standard (i.e., in surplus or deficit).**

81. Before the adoption of this Standard, entities may have adopted accounting policies for the recognition and reversal of impairment losses. On adoption of this Standard, a change in accounting policy may arise. It would be difficult to determine the amount of adjustments resulting from a retrospective application of the change in accounting policy. Therefore, on adoption of this Standard, an entity shall not apply the benchmark or the allowed alternative treatment for other changes in accounting policies in IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors."

Effective Date

82. **An entity shall apply this IPSAS for annual periods beginning on or after January 1, 2006. Earlier application is encouraged. If an entity applies this Standard for an earlier period it shall disclose that fact.**

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

Appendix A

Indications of Impairment—Examples

This appendix sets out examples of impairment indications discussed in the Standard, to assist in clarifying their meaning. It does not form part of the Standard.

External Sources of information

(a) **Cessation, or near cessation, of the demand or need for services provided by the asset.**

The asset still maintains the same service potential, but demand for that service has ceased or nearly ceased. Examples of assets impaired in this manner include:

(i) A school closed because of a lack of demand for school services arising from a population shift to other areas. It is not anticipated that this demographic trend affecting the demand for the school services will reverse in the foreseeable future;

(ii) A school designed for 1,500 students currently has an enrollment of 150 students – the school cannot be closed because the nearest alternative school is 100 kilometers away. The entity does not envisage the enrollment increasing. At the time of establishment enrollment was 1,400 students – the entity would have acquired a much smaller facility had future enrollment been envisaged to be 150 students. The entity determines that demand has nearly ceased and the recoverable service amount of the school should be compared with its carrying amount;

(iii) A railway line closed due to lack of patronage (for example, the population in a rural area has substantially moved to the city due to successive years of drought, and those that have stayed behind use the cheaper bus service); and

(iv) A stadium whose principal occupant does not renew its occupancy agreement with the result that the facility is expected to close.

(b) **Significant long-term changes with an adverse effect on the entity in the technological, legal or government policy environment in which the entity operates.**

Technological Environment

The service utility of an asset may be reduced if technology has advanced to produce alternatives that provide better or more efficient service. Examples of assets impaired in this manner are:

(i) Medical diagnostic equipment that is rarely or never used because a newer machine embodying more advanced technology provides more accurate results (would also meet indication (a) above);

(ii) Software that is no longer being supported by the external supplier because of technological advances and the entity does not have the personnel to maintain the software; and

(iii) Computer hardware that has become obsolete as the result of technological development.

Legal or Government Policy Environment

An asset's service potential may be reduced as a result of a change in a law or regulation. Examples of impairments identified by this indication include:

(iv) An automobile that does not meet new emission standards or an airplane that does not meet new noise standards;

(v) A school that can no longer be used for instruction purposes due to new safety regulations regarding its building materials or emergency exits; and

(vi) A drinking water plant that cannot be used because it does not meet new environmental standards.

Internal sources of information

(c) **Evidence is available of physical damage of an asset.**

Physical damage would likely result in the asset being unable to provide the level of service that it once was able to provide. Examples of assets impaired in this way include:

(i) A building damaged by fire or flood or other factors;

(ii) A building that is closed due to identification of structural deficiencies;

(iii) Sections of an elevated roadway that have sagged, indicating that these sections of roadway will need to be replaced in 15 years rather than the original design life of 30 years;

(iv) A dam whose spillway has been reduced as a result of a structural assessment;

(v) A water treatment plant whose capacity has been reduced by an intake blockage and the removal of the blockage is not economical;

(vi) A bridge that is weight restricted due to identification of structural deficiencies;

(vii) A navy destroyer damaged in a collision; and

(viii) Equipment that is damaged and can no longer be repaired or for which repairs are not economically feasible.

(d) **Significant long-term changes, with an adverse effect on the entity, in the extent to which an asset is used, or is expected to be used.**

The asset still maintains the same service potential, but long term changes have an adverse effect on the extent to which the asset is used. Examples of circumstances in which assets may be impaired in this manner include:

(i) If an asset is not being used to the same degree as it was when originally put into service, or the expected useful life of the asset is shorter than originally estimated, the asset may be impaired. An example of an asset that might be identified as potentially being impaired by this indication is a mainframe computer that is underutilized because many applications have been converted or developed to operate on servers or PC platforms. A significant long-term decline in the demand for an asset's services may translate itself into a significant long-term change in the extent to which the asset is used.

(ii) If the asset is not being used in the same way as it was when originally put into service, the asset may be impaired. An example of an impaired asset that might be identified by this indication is a school building that is being used for storage rather than for educational purposes.

(e) **A decision to halt the construction of the asset before it is complete or in a usable condition.**

An asset that will not be completed cannot provide the service intended. Examples of assets impaired in this manner include those where:

(i) Construction was stopped due to identification of an archaeological discovery or environmental condition such as a nesting ground for a threatened or endangered species; or

(ii) Construction was stopped due to a decline in the economy.

The circumstances that led to the halting of construction will also be considered. If construction is deferred, that is, postponed to a specific future date, the project could still be treated as work in progress and is not considered as halted.

(f) **Evidence is available from internal reporting that indicates that the service performance of an asset is, or will be, significantly worse than expected.**

Internal reports may indicate that an asset is not performing as expected or its performance is deteriorating over time. For example, an internal health department report on operations of a rural clinic may indicate that an x-ray machine used by the clinic is impaired because the cost of maintaining the machine has significantly exceeded that originally budgeted.

Appendix B

Measurement of Impairment Loss—Examples

This appendix illustrates the application of the provisions of the Standard to assist in clarifying their meaning. It does not form part of the Standard. The facts assumed in these examples are illustrative only and are not intended to modify or limit the requirements of the Standard or to indicate the IPSASB's endorsement of the situations or methods illustrated. Application of the provisions of this Standard may require assessment of facts and circumstances other than those illustrated here.

Note: In the following examples, it is assumed that the fair value less costs to sell of the asset tested for impairment is less than its value in use or is not determinable, unless otherwise indicated. Therefore, the asset's recoverable service amount is equal to its value in use. In these examples the straight line method of depreciation is used.

Example 1: Depreciated Replacement Cost Approach

Significant Long-term Change with Adverse Effect on the Entity in the Technological Environment—Underutilized mainframe computer

In 1999, the City of Kermann purchased a new mainframe computer at a cost of CU10 million[1]. Kermann estimated that the useful life of the computer would be seven years and that on average 80 percent of central processing unit (CPU) capacity would be used by the various departments. A buffer of excess CPU time of 20 percent was expected and needed to accommodate scheduling jobs to meet peak period deadlines. Within a few months after acquisition, CPU usage reached 80 percent, but declined to 20 percent in 2003 because many applications of the departments were converted to run on desktop computers or servers. A computer is available on the market at a price of CU500,000 that can provide the remaining service potential of the mainframe computer using the remaining applications.

Evaluation of Impairment

The indication of impairment is the significant long-term change in the technological environment resulting in conversion of applications from the mainframe to other platforms and therefore decreased usage of the mainframe computer. (Alternatively it can be argued that a significant decline in the extent of use of the mainframe indicates impairment.) Impairment loss is determined using the depreciated replacement cost approach as follows:

a	**Acquisition cost, 1999**	**10,000,000**
	Accumulated depreciation, 2003 (a × 4 ÷ 7)	**5,714,286**
b	**Carrying amount, 2003**	**4,285,714**
c	**Replacement cost**	**500,000**
	Accumulated depreciation(c × 4 ÷ 7)	**285,714**
d	**Recoverable Service Amount**	**214,286**
	Impairment loss (b - d)	**4,071,428**

1 In these examples monetary amounts are denominated in “currency units” (CU).

Example 2: Depreciated Replacement Cost Approach

Near cessation in demand for the services provided by a non-cash-generating asset—Underutilized Mainframe Software Application

In 1999, the City of Kermann purchased a software license for an application for its new mainframe computer for CU350,000. Kermann estimated that the useful life of the software would be seven years and that it would receive economic benefits and service potential from the software on a straight-line basis over the life of the software. By 2003, usage of the application had declined to 15 percent of its originally anticipated demand. A license for a software application to replace the remaining service potential of the impaired software application costs CU70,000.

Evaluation of Impairment

The indication of impairment is technological change, brought about by the loss of mainframe computer capacity.

a	**Acquisition cost, 1999**	**350,000**
	Accumulated depreciation, 2003 (a × 4 ÷ 7)	**200,000**
b	**Carrying amount, 2003**	**150,000**
c	**Replacement cost**	**70,000**
	Accumulated amortization (c × 4 ÷ 7)	**40,000**
d	**Recoverable Service Amount**	**30,000**
	Impairment loss (b - d)	**120,000**

Example 3: Depreciated Replacement Cost Approach

Significant Long-term Change with Adverse Effect on the Entity in the Manner of Use—School used as warehouse

In 1997, Lunden School District constructed an elementary school at a cost of CU10 million. The estimated useful life of the school is fifty years. In 2003, the school is closed because enrollments in the district declined unexpectedly due to a population shift caused by the bankruptcy of a major employer in the area. The school is converted to use as a storage warehouse, and Lunden School District has no expectation that enrollments will increase in the future such that the building would be reopened for use as a school. The current replacement cost for a warehouse with the same storage capacity as the school is CU4.2 million.

Evaluation of Impairment

Impairment is indicated because the purpose for which the building is used has changed significantly from a place for instructing students to a storage facility and this is not anticipated to change for the foreseeable future. An impairment loss using depreciated replacement cost approach would be determined as follows:

a	**Historical cost, 1997**	**10,000,000**
	Accumulated depreciation, 2003 (a × 6 ÷ 50)	**1,200,000**
b	**Carrying amount, 2003**	**8,800,000**
c	**Replacement cost of a storage facility of similar capacity**	**4,200,000**
	Accumulated depreciation (c × 6 ÷ 50)	**504,000**
d	**Recoverable Service Amount**	**3,696,000**
	Impairment loss (b - d)	**5,104,000**

Example 4: Depreciated Replacement Cost Approach

Significant Long-term Change with Adverse Effect on the Entity in the Extent of Use—School partially closed due to decline in enrollment

In 1983, the Lutton School District constructed a school at the cost of CU2.5 million. The entity estimated the school would be used for 40 years. In 2003, the enrollment declined from 1000 to 200 students as the result of population shift caused by the bankruptcy of a major employer in the area. The management decided to close the top two floors of the three story school building. Lutton School District has no expectation that enrollments will increase in the future such that the upper stories would be reopened. The current replacement cost of the one story school is estimated at CU1.3 million.

Evaluation of Impairment

Impairment is indicated because the extent of use of the school has changed from three floors to one floor as the result of a reduction in the number of students from 1000 to 200 students. The reduction in the extent of use is significant and the enrollment is expected to remain at the reduced level for the foreseeable future. Impairment loss using a depreciated replacement cost approach would be determined as follows:

a	**Acquisition cost, 1983**	**2,500,000**
	Accumulated depreciation, 2003 (a × 20 ÷ 40)	**1,250,000**
b	**Carrying amount, 2003**	**1,250,000**
c	**Replacement cost**	**1,300,000**
	Accumulated depreciation (c × 20 ÷ 40)	**650,000**
d	**Recoverable Service Amount**	**650,000**
	Impairment loss (b - d)	**600,000**

Example 5: Restoration Cost Approach

Physical Damage—School bus damaged in road accident

In 1998, North District Primary School acquired a bus at the cost of CU200,000 to help students from a nearby village to commute free of charge. The school estimated a useful life of 10 years for the bus. In 2003, the bus sustained damage in a road accident requiring CU40,000 to be restored to a usable condition. The restoration will not affect the useful life of the asset. The cost of a new bus to deliver a similar service is CU250,000 in 2003.

Evaluation of Impairment

Impairment is indicated because the bus has sustained physical damage in the road accident. Impairment loss using the restoration cost approach would be determined as follows:

a	**Acquisition cost, 1998**	**200,000**
	Accumulated depreciation, 2003 (a × 5 ÷ 10)	**100,000**
b	**Carrying amount, 2003**	**100,000**
c	**Replacement cost**	**250,000**
	Accumulated depreciation (c × 5 ÷ 10)	**125,000**
d	**Depreciated replacement cost (undamaged state)**	**125,000**
	Less: restoration cost	**40,000**
e	**Recoverable Service Amount**	**85,000**
	Impairment loss (b - e)	**15,000**

Example 6: Restoration Cost Approach

Physical Damage—Building damaged by fire

In 1984, the City of Moorland built an office building at a cost of CU50 million. The building was expected to provide service for 40 years. In 2003, after 19 years of use, fire caused severe structural problems. Due to safety reasons, the office building is closed and structural repairs costing CU35.5 million are to be made to restore the office building to an occupiable condition. The replacement cost of a new office building is CU100 million.

Evaluation of Impairment

Impairment is indicated because the office building has sustained physical damage due to the fire. Impairment loss using a restoration cost approach would be determined as follows:

a	**Acquisition cost, 1984**	**50,000,000**
	Accumulated depreciation, 2003 (a × 19 ÷ 40)	**23,750,000**
b	**Carrying amount, 2003**	**26,250,000**
c	**Replacement cost (of a new building)**	**100,000,000**
d	**Accumulated depreciation (c × 19 ÷ 40)**	**47,500,000**
	Depreciated replacement cost (undamaged)	**52,500,000**
	Less: restoration cost	**35,500,000**
e	**Recoverable Service Amount**	**17,000,000**
	Impairment loss (b - e)	**9,250,000**

Example 7: Service Units Approach

Significant Long-term Change with Adverse Effect on the Entity in the Extent of Use—High rise building partially unoccupied for the foreseeable future

In 1988, Ornong City Council constructed a 20 story office building for use by the Council in downtown Ornong at the cost of CU80 million. The building was expected to have a useful life of 40 years. In 2003, National Safety Regulations required that the top 4 stories of high rise buildings should be left unoccupied for the foreseeable future. The building has a fair value less costs to sell of CU45 million in 2003 after regulations came into force. The current replacement cost of a similar 20 story building is CU85 million.

Evaluation of Impairment

Impairment is indicated because the extent of use of the office building has changed from 20 floors to 16 floors as the result of new National Safety Regulations. The reduction in the extent of use is significant and the occupation of the building is expected to remain at the reduced level (16 floors) for the foreseeable future. Impairment loss using the service units approach would be determined as follows:

a	**Acquisition cost, 1988**	**80,000,000**
	Accumulated depreciation, 2003 (a × 15 ÷ 40)	**30,000,000**
b	**Carrying amount, 2003**	**50,000,000**
c	**Replacement cost (20 story building)**	**85,000,000**
	Accumulated depreciation (c × 15 ÷ 40)	**31,875,000**
d	**Depreciated replacement cost before adjustment for remaining service units**	**53,125,000**
e	**Value in Use of the building after the regulation came into force (d × 16 ÷ 20)**	**42,500,000**
f	**Fair value less costs to sell of the building after regulation came into force**	**45,000,000**
g	**Recoverable service amount (higher of e and f)**	**45,000,000**
	Impairment loss (b - g)	**5,000,000**

Example 8: Service Units Approach

Evidence from Internal Reporting—Higher cost of operating the printing machine

In 1998, Country X Education Department purchased a new printing machine at a cost of CU40 million. The Department estimated that the useful life of the machine would be 40 million copies of books to be printed over 10 years for use by elementary school students. In 2003, it was reported that an automated feature of the machine's function does not operate as expected resulting in a 25 percent reduction in the machine's annual output level over the remaining 5 years of the useful life of the asset. The replacement cost of a new printing machine is CU45 million in 2003.

Evaluation of Impairment

Impairment is indicated by evidence from internal reporting that the service performance of the printing machine is worse than expected. Circumstances suggest that the decline in the service potential of the asset is significant and of long-term nature. Impairment loss using a service units approach is determined as follows:

a	**Acquisition cost, 1998**	**40,000,000**
	Accumulated depreciation (a × 5 ÷ 10)	**20,000,000**
b	**Carrying amount, 2003**	**20,000,000**
c	**Replacement cost**	**45,000,000**
	Accumulated depreciation (c × 5 ÷ 10)	**22,500,000**
d	**Depreciated replacement cost before adjustment for remaining service units**	**22,500,000**
e	**Recoverable Service Amount (d × 75%)**	**16,875,000**
	Impairment loss (b - e)	**3,125,000**

Basis for Conclusions

This appendix gives the IPSASB's reasons for supporting or rejecting certain solutions related to the accounting for non-cash-generating impairment of assets. It also identifies circumstances in which the requirements of this IPSAS depart from the requirements of IAS 36 and the reasons for such departure. This appendix does not form part of the Standard.

Introduction

BC1. The accrual IPSASs are based on the IFRSs issued by the IASB, to the extent that the requirements of those Standards are applicable to the public sector. The requirements of this Standard have been developed consistent with that policy. International Accounting Standard IAS 36 requires entities to determine the recoverable amount of an asset if there are indications that the asset is impaired. The recoverable amount of an asset is defined as the higher of value in use and fair value less costs to sell of the asset. This Standard includes a similar definition.

BC2. IAS 36 applies to cash-generating assets and cash-generating units, whilst this Standard applies to individual non-cash-generating assets. This results in a number of differences between the two Standards. The main differences are:

(a) The method of measurement of value in use of a non-cash-generating asset under this Standard is different to that applied to a cash-generating asset under IAS 36;

(b) This Standard does not require entities to apply an impairment test to property, plant and equipment carried at revalued amounts; and

(c) This Standard does not include a decrease in market value significantly greater than would be expected as a result of the passage of time or normal use as a minimum indication of impairment. This indication is included as an additional indication that impairment may exist.

The IPSASB's reasons for making these departures from the requirements of IAS 36 are explained in the paragraphs below.

BC3. An Invitation to Comment, (ITC) "Impairment of Assets" issued in 2000 proposed an approach to accounting for impairment of the assets of public sector entities that applied IAS 36 to the extent that it was appropriate. ED 23, "Impairment of Assets" was developed after consideration of responses to the ITC and issued in 2003. This Standard was developed after consideration of the responses to ED 23.

Cash-Generating Assets

BC4. IAS 36 requires an entity to determine value in use as the present value of estimated future cash flows expected to be derived from the continuing use of the asset, or cash-generating unit, and from its disposal at the end of its useful life. The service potential of cash-generating assets is reflected by their ability to generate future cash flows. IPSAS 26 is based on IAS 36. The requirements of IPSAS 26 are applicable to cash-generating assets held by public sector entities. This Standard requires entities to apply IPSAS 26 to account for impairment of cash-generating assets in the public sector.

Non-Cash-Generating Assets

BC5. In considering the principles underpinning a value in use concept applicable to non-cash-generating assets, the IPSASB agreed that the value in use of a non-cash-generating asset should be measured by reference to the present value of the remaining service potential of the asset. This replicates the approach taken by IAS 36.

Determination of Value in Use

BC6. Determining value in use (present value of remaining service potential) of a non-cash-generating asset, may be approached in a number of ways. One approach that replicates IAS 36 involves estimating and discounting cash inflows that would have arisen had the entity sold its services or other outputs in the market. However, the IPSASB is of the view that it is unlikely that this approach could be used in practice due to the complexities involved in determining the appropriate prices at which to value the service or other output units and estimating the appropriate discount rate.

BC7. Other approaches reflect an implicit determination of value in use. In this respect, the IPSASB considered the market value approach, and approaches that measure depreciated replacement cost, and include consideration of restoration cost and service units.

Market value approach

BC8. Under this approach, where an active market exists for the asset, the value in use of the non-cash-generating asset is measured at the observable market value of the asset. Where an active market for the asset is not available, the entity uses the best available market evidence of the price at which the asset could be exchanged between knowledgeable, willing parties in an arm’s length transaction, having regard to the highest and best use of the asset for which market participants would be prepared to pay in the prevailing circumstances. The IPSASB noted that the use of the observable market value as a proxy for value in use was redundant since market value differed from the fair value less costs to sell (the other arm of the recoverable service amount estimate) of the asset only by the amount of the costs of disposal.

Therefore the market value would be effectively captured by the fair value less costs to sell arm of recoverable service amount.

Depreciated replacement cost approach

BC9. Under this approach, the value in use of the asset is determined as the lowest cost at which the gross service potential embodied in the asset could be obtained in the normal course of operations less the value of the service potential already consumed. This approach assumes that the entity replaces the remaining service potential of the asset if it is deprived of it. An asset may be replaced either through reproduction (such as specialized assets) or through replacement of its gross service potential. Therefore, value in use is measured as the reproduction or replacement cost of the asset, whichever is lower, less accumulated depreciation calculated on the basis of such cost to reflect the already consumed or expired service potential of the asset.

Restoration cost approach

BC10. This approach is usually used when impairment losses arise from damage. Under this approach, the value in use of the asset is determined by subtracting the estimated restoration cost of the asset from the depreciated replacement or reproduction cost of the asset before impairment.

Service units approach

BC11. This approach determines the value in use of the asset by reducing the depreciated replacement or reproduction cost of the asset before impairment to conform to the reduced number of service units expected from the asset in its impaired state.

Approaches adopted

BC12. The IPSASB agreed that the value in use of a non-cash-generating asset will be measured using the depreciated replacement cost, the restoration cost or the service units approaches cited above as appropriate.

Other Assets

BC13. IAS 36 contains specific requirements for testing intangible assets for impairment, and for recognizing and measuring impairment losses related to intangible assets. These requirements complement the requirements of IAS 38, “Intangible Assets.” The IPSASB has not issued an IPSAS on intangible assets, so has not considered the applicability of the IAS 36 impairment requirements to non-cash-generating intangible assets in the public sector. Non-cash-generating intangible assets are not excluded from the scope of this Standard. Therefore this Standard applies to those assets. Public sector intangible assets such as those reflecting the entity’s ability to issue licenses may arise in a cash-generating context. Other intangible assets may arise in a non-cash-generating context and should be tested for impairment according to the requirements of this Standard.

Group of Assets and Corporate Assets

BC14. Under IAS 36, where it is not possible to determine the recoverable amount for an individual asset, then the recoverable amount for the asset's cash-generating unit (CGU) will be determined. The CGU is the smallest identifiable group of assets that generates cash inflows from continuing use, and that is largely independent of the cash inflows from other assets or groups of assets. The IPSASB considered the concept of a service-generating unit in a non-cash-generating context. It noted that as the requirements in this Standard are applied to individual assets, the adoption of such a concept by analogy to the CGU concept in IAS 36 is unnecessary because it is possible to identify the service potential of individual assets. Moreover, its adoption would introduce undue complexities in accounting for impairment of non-cash-generating assets.

BC15. Under IAS 36, assets other than goodwill that contribute to the future cash flows of two or more CGUs are regarded as corporate assets. In a cash-generating context, because corporate assets do not generate separate cash inflows, the impairment of corporate assets are dealt with as part of the impairment of the cash-generating unit to which the corporate assets belong. The IPSASB observed that in a non-cash-generating context, the concept of a service-generating unit is not warranted as noted in paragraph C14 above. The IPSASB further noted that such assets are often an integral part of the service delivery function and their impairment is to be dealt with as for any other non-cash-generating assets of the entity.

Property, Plant and Equipment

BC16. The Standard does not require the application of an impairment test to non-cash-generating assets that are carried at revalued amounts under the allowed alternative treatment in IPSAS 17. The IPSASB is of the view that under the allowed alternative treatment in IPSAS 17, assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value as at the reporting date and any impairment will be taken into account in the valuation. Therefore any difference between the asset's carrying amount and its fair value less costs to sell will be the disposal costs. The IPSASB is of the view that, in most cases, these will not be material and, from a practical viewpoint, it is not necessary to measure an asset's recoverable service amount and to recognize an impairment loss for the disposal costs of a non-cash-generating asset.

BC17. In contrast to this Standard, IAS 36 requires entities to test revalued property, plant and equipment for impairment after they had been revalued. The rationale for this difference can be explained by reference to the factors set out in paragraphs C18 and C19 below.

BC18. Firstly, there are different methods of determining recoverable service amount under this Standard and of determining recoverable amount under IAS 36. Recoverable service amount is defined in this Standard as the higher of a non-cash-generating asset's fair value less costs to sell and its value in use. Under this Standard, an entity determines an asset's value in use by determining the current cost to replace the asset's remaining service potential. The current cost to replace the asset's remaining service potential is determined using the depreciated replacement cost approach, and approaches described as the restoration cost approach, and the service units approach. These approaches may also be adopted to measure fair value under IPSAS 17 – therefore the value in use is a measure of fair value. Recoverable amount is defined in IAS 36 as the higher of an asset's fair value less costs to sell and its value in use. Value in use under IAS 36 is determined using the present value of the cash flows expected to be derived from continued use of the asset and its eventual disposal. IAS 36 states that the value in use may be different from the fair value of the asset.

BC19. Secondly, the requirement under IAS 36 to combine non-cash-generating assets with cash-generating assets to form a cash-generating unit is not replicated in this Standard. Under IAS 36, where an asset does not produce cash inflows it is combined with other assets to form a cash-generating unit, the value in use of which is then measured. The sum of the fair values of the assets that make up a cash-generating unit may be different to the value in use of the cash-generating unit.

Impairment of Non-Cash-Generating Assets Held by Government Business Enterprises

BC20. This Standard requires that the impairment of all assets held by Government Business Enterprises (GBEs) be accounted for under IAS 36. GBEs are profit-oriented entities and the assets employed by them are primarily cash-generating assets. The *Preface to International Financial Reporting Standards* has made it clear that IASB Standards are to be applied by profit-oriented entities. GBEs are profit-oriented entities and are therefore required to comply with IFRSs and IASs. Individual IPSASs make it explicit that IFRSs apply to GBEs. Accordingly, non-cash-generating assets are expected to be appropriately grouped with cash-generating assets of GBEs to form a cash-generating unit to be tested for impairment in accordance with IAS 36.

Indications of Impairment – Changes in Market Value

BC21. IAS 36 includes as a minimum indication of impairment that an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use. The IPSASB has included this as an additional indication of impairment, but not as a minimum indication of impairment. The IPSASB is of the view that these changes in market value do not necessarily indicate that a non-cash-generating asset is impaired. This is because non-cash-generating assets are held for reasons other than generating a commercial return, therefore a change in market value may not reflect a change in the amount of service that the entity will recover from continued use of the asset.

Reversal of Impairment

BC22. Paragraph 60(a) includes resurgence of demand or need for services provided by the asset as a minimum indication of reversal of impairment, whilst paragraph 62(b) includes a significant long-term increase in demand or need for the services provided by the asset as an additional indication of possible reversal of impairment. The wording of these two indications is similar, however they can be distinguished from each other because paragraph 60(a) refers to a resurgence of the demand that had declined and resulted in the recognition of an impairment loss. Paragraph 62(b) refers to new demand, and may be unrelated to the reason an impairment loss was recognized in respect of the asset.

BC23. Paragraph 62(a) includes a significant rise in an asset's market value as an additional indication of reversal of impairment. This does not mirror the indication of impairment in paragraph 27(a), which requires that the decline in market value be significantly more than would be expected as a result of the passage of time or normal use. This difference means that the increase in market value may be expected or unexpected.

BC24. Paragraph 27(c) includes evidence is available of physical damage of an asset as a minimum indication of impairment. Paragraph 60 does not include an indication of reversal of impairment that mirrors this indication of impairment. The IPSASB has not included repair of an asset as an indication of reversal because IPSAS 17 requires entities to add subsequent expenditure to the carrying amount of an item of property, plant and equipment when it is probable that future economic benefits or service potential over the total life of the asset, in excess of the most recently assessed standard of performance of the existing asset, will flow to the entity. This requirement also applies to investment property that is measured using the cost model under IPSAS 16. The IPSASB is of the view that these requirements negate the need for an indication of reversal of impairment that mirrors the physical damage indication of impairment. The IPSASB also noted that restoration or repair of damage does not constitute a change in the estimate of the asset's recoverable service amount after impairment as specified by paragraph 65 of this IPSAS.

Comparison with IAS 36 (2004)

IPSAS 21, "Impairment of Non-Cash-Generating Assets" deals with the impairment of non-cash-generating assets in the public sector. The main differences between IPSAS 21 and IAS 36 (2004), "Impairment of Assets" are as follows:

- IPSAS 21 deals with the impairment of non-cash-generating assets of public sector entities while IAS 36 deals with the impairment of cash-generating assets of profit-oriented entities. IPSAS 21, however, requires that the impairment of cash-generating assets of public sector entities be accounted for under IAS 36.
- IPSAS 21 does not apply to non-cash-generating assets carried at revalued amounts at the reporting date under the allowed alternative treatment in IPSAS 17. IAS 36 does not exclude from its scope cash-generating property, plant and equipment carried at revalued amounts at the reporting date.
- The method of measurement of value in use of a non-cash-generating asset under IPSAS 21 is different from that applied to a cash-generating asset under IAS 36. IPSAS 21 measures the value in use of a non-cash-generating asset as the present value of the asset's remaining service potential using a number of approaches. IAS 36 measures the value in use of a cash-generating asset as the present value of future cash flows from the asset.
- IPSAS 21 does not include a change in the market value of the asset as a black letter indication of impairment. A significant, unexpected decline in market value appears in black letter in IAS 36 as part of the minimum set of indications of impairment while IPSAS 21 refers to it in commentary.
- IPSAS 21 includes a decision to halt the construction of an asset before completion as a black letter indication of impairment and the resumption of the construction of the asset as an indication of reversal of the impairment loss. There are no equivalents in IAS 36.
- The scope of IAS 36 excludes certain classes of assets that are not excluded from the scope of IPSAS 21. These exclusions relate to classes of assets which are the subject of specific impairment requirements under other IFRSs. These have not been excluded from IPSAS 21 because there are not equivalent IPSASs. These exclusions include biological assets related to agricultural activity, deferred tax assets, deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts within the scope of IFRS 4, "Insurance Contracts" and non-current assets (or disposal groups) classified as held for sale in accordance with IFRS 5, "Non-current Assets Held for Sale and Discontinued Operations."

- IPSAS 21 deals with the impairment of individual assets. There is no equivalent in IPSAS 21 for a cash-generating unit as defined in IAS 36.
- IPSAS 21 deals with corporate assets in the same manner as other non-cash-generating assets while IAS 36 deals with them as part of related cash-generating units.
- IPSAS 21 uses different terminology, in certain instances, from IAS 36. The most significant examples are the use of the terms revenue, recoverable service amount, statement of financial performance and statement of financial position in IPSAS 21. The equivalent terms in IAS 36 are income, recoverable amount, income statement and balance sheet.

December 2006

IPSAS 22—DISCLOSURE OF FINANCIAL INFORMATION ABOUT THE GENERAL GOVERNMENT SECTOR

CONTENTS

International Public Sector Accounting Standard (IPSAS) 22, "Disclosure of Financial Information about the General Government Sector" is set out in paragraphs 1–48 and the Appendix. All the paragraphs have equal authority. IPSAS 22 should be read in the context of its objective, the Basis for Conclusions, and the "Preface to the International Public Sector Accounting Standards." IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for Issuing the IPSAS

IN1. Statistical bases of financial reporting such as the *System of National Accounts 1993* (SNA 93 and updates), *Government Finance Statistics Manual 2001* (GFSM 2001), and the *European System of Accounts 1995* (ESA 95) require governments to compile financial information about the general government sector (GGS). For statistical purposes, the GGS comprises government controlled entities primarily engaged in nonmarket activities. The GGS is sometimes described as comprising those entities that fulfill the core functions of government as their primary activity.

IN2. Current IPSASs require entities to prepare financial statements that include information about all the resources controlled by the reporting entity, and prescribe rules for consolidation of all controlled entities. IPSASs also require financial statements to make disclosures about segments. A segment is defined as a distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of evaluating the entity's past performance in achieving its objectives and for making decisions about the future allocation of resources. IPSASs do not require public sector entities to disclose information about the GGS in their financial statements.

IN3. This Standard establishes requirements for governments which elect to disclose information about the GGS and prepare financial statements under the accrual basis of accounting as prescribed by IPSASs. The disclosures required by this Standard provide a useful bridge to the statistical bases of reporting.

Main Features of the Standard

IN4. This Standard establishes requirements for preparing and presenting information about the GGS. The Standard is only applied in respect of a government's consolidated financial statements. Information disclosed in accordance with this standard disaggregates those consolidated financial statements according to the GGS boundaries as specified in statistical bases of financial reporting. The Standard does not permit reporting entities to consolidate information about entities that are not subject to common control, as statistical information about government finances published by a statistical agency would.

IN5. This Standard requires entities electing to make GGS disclosures to apply all IPSASs to those disclosures except IPSAS 6, "Consolidated and Separate Financial Statements." Statistical bases of financial reporting use different consolidation rules to IPSAS 6; applying IPSAS 6 would not enable comparison of financial statement information with GGS information.

IN6. This Standard requires a different treatment of investments in the public corporations sectors than is normally required by IPSASs. IPSAS 6 requires full consolidation of all entities, however, this Standard requires the public financial corporations sector and the public non-financial corporations sector to be presented as investments of the general government sector.

IN7. Making the GGS disclosures set out in this IPSAS does not exempt entities from the operation of IPSAS 18, "Segment Reporting."

IN8. This Standard applies for annual periods beginning on or after January 1, 2008, but earlier application is encouraged.

IPSAS 22—DISCLOSURE OF FINANCIAL INFORMATION ABOUT THE GENERAL GOVERNMENT SECTOR

Objective

1. The objective of this Standard is to prescribe disclosure requirements for governments which elect to present information about the general government sector (GGS) in their consolidated financial statements. The disclosure of appropriate information about the GGS of a government can enhance the transparency of financial reports, and provide for a better understanding of the relationship between the market and nonmarket activities of the government and between financial statements and statistical bases of financial reporting.

Scope

2. **A government that prepares and presents consolidated financial statements under the accrual basis of accounting and elects to disclose financial information about the general government sector shall do so in accordance with the requirements of this Standard.**

3. Governments raise funds from taxes, transfers and a range of nonmarket and market activities to fund their service delivery activities. They operate through a variety of entities to provide goods and services to their constituents. Some entities rely primarily on appropriations or allocations from taxes or other government revenues to fund their service delivery activities, but may also undertake additional revenue generating activities including commercial activities in some cases. Other entities may generate their funds primarily or substantially from commercial activities. These include government business enterprises (GBEs) as defined in paragraph 15 of this Standard.

4. Financial statements for a government prepared in accordance with IPSASs provide an overview of the assets controlled and liabilities incurred by the government, the cost of services provided by the government and the taxation and other revenues generated to fund the provision of those services. Financial statements for a government, which delivers services through controlled entities, whether primarily dependent on the government budget to fund their activities or not, are consolidated financial statements.

5. In some jurisdictions, financial statements and budgets for the government, or sectors thereof, may also be issued in accordance with statistical bases of financial reporting. These bases reflect requirements consistent with, and derived from, the System of National Accounts 1993 (SNA 93) prepared by the United Nations and other international organizations. These statistical bases of financial reporting focus on the provision of financial information about the GGS. The GGS comprises those nonprofit entities which undertake nonmarket activities and rely primarily on appropriations or allocations from the government budget to fund their service delivery activities (hereafter

referred to as nonmarket entities or activities). The statistical bases of financial reporting may also provide information about the corporations sector of government which primarily engages in market activities (usually characterized as the public financial corporations (PFC) sector and the public nonfinancial corporations (PNFC) sector) and the public sector as a whole. The major features of the PFC and PNFC sectors are outlined at paragraphs 19 and 20 of this Standard.

6. Financial statements consolidate only controlled entities. Such a limitation is not made in statistical bases of financial reporting. In some jurisdictions a national government controls state/provincial and local government entities, and therefore its financial statements consolidate those levels of government, but in other jurisdictions they do not. In all jurisdictions, under statistical bases of financial reporting, the GGS of all levels of government are combined, so in some jurisdictions the GGS will include units that financial statements do not consolidate. This Standard disaggregates the consolidated financial statements of a government. Therefore, it prohibits the presentation, as part of the GGS, of any entity not consolidated within a government's financial statements.

Segment Reporting

7. IPSAS 18 requires the disclosure of certain information about the service delivery activities of the entity and the resources allocated to support those activities for accountability and decision-making purposes. Unlike the sectors reported under statistical bases of financial reporting, segments reported in accordance with IPSAS 18 are not based on a distinction between market and nonmarket activities.

8. The disclosure of information about the GGS does not replace the need to make disclosures about segments in accordance with IPSAS 18. This is because information about the GGS alone will not provide sufficient detail to enable users to evaluate the entity's past performance in achieving major service delivery objectives, when those objectives are achieved through non-GGS entities. For example, identifying the GGS as a segment will not provide information about a government's performance in achieving its telecommunication, healthcare or educational objectives where government corporations or quasi-corporations deliver services related to those objectives. Because the GGS is only a subset of the government as a whole, important information would be omitted if a government did not present segment information in respect of its consolidated financial statements.

Statistical Bases of Financial Reporting

9. The objectives of financial statements prepared in accordance with IPSASs and those prepared in accordance with statistical bases of financial reporting differ in some respects. The objectives of financial statements prepared in accordance with IPSASs are to provide information useful for decision-

making and to demonstrate the accountability of the entity for the resources entrusted to it and which it controls. The purpose of financial statements prepared in accordance with statistical bases of financial reporting is to provide information suitable for analyzing and evaluating fiscal policy, especially the performance of the GGS and the broader public sector of any country. In addition, although statistical bases of financial reporting may be described in accounting terms, they might differ in important ways from the underlying financial accounting system from which most of the statistics about government finances will be derived. However, the IPSASs and the statistical bases of financial reporting also have many similarities in the treatment of transactions and events. For example, they adopt an accrual basis of accounting, deal with similar transactions and events, and in some respects require a similar type of report structure.

10. In some jurisdictions, the disclosure of appropriate information about the GGS in financial statements can support and enhance the decisionmaking of, and accountability to, users of those statements. For example, disclosure of information about the GGS is consistent with enhanced transparency of financial reporting and will assist users of the financial statements to better understand:

    (a) The resources allocated to support the service delivery activities by the GGS, and the government's financial performance in delivering those services; and

    (b) The relationship between the GGS and the corporations sectors, and the impact each have on overall financial performance.

11. In those jurisdictions where financial statements for the government are prepared in accordance with statistical bases of financial reporting and widely published, the disclosure of information about the GGS in financial statements will form a useful link between the financial statements prepared in accordance with IPSASs and those prepared in accordance with statistical bases of financial reporting. This will assist users in reconciling information presented in financial statements to information presented in statistical reports. IPSAS 24, "Presentation of Budget Information in Financial Statements," requires that financial statements include a comparison of budget and actual amounts on a basis consistent with that adopted for the budget. Where government budgets are prepared for the GGS rather than the government as a whole, financial information about the GGS disclosed in accordance with this Standard will be relevant to the comparisons required by that IPSAS.

Accounting Policies

12. IPSAS 3 requires the development of accounting policies to ensure that the financial statements provide information that meets a number of qualitative characteristics. The compilation and presentation of GGS data which satisfy

the qualitative characteristics of information provided in financial statements and related audit requirements may add significantly to the workload of preparers and auditors in many jurisdictions, and may increase the complexity of the financial statements. This will be particularly so in jurisdictions where financial statements based on, or incorporating, GGS disclosures in accordance with statistical bases of financial reporting are not currently prepared. In addition, in some jurisdictions users may not be dependent on financial statements for information about the GGS. In those jurisdictions, the costs involved in preparing and presenting GGS disclosures as part of the financial statements may be greater than their benefit. Therefore, this Standard allows, but does not require, the disclosure of information about the GGS. Whether or not disclosure of information about the GGS will be made in financial statements, will be determined by the government or other appropriate authority in each jurisdiction.

13. This Standard requires that when disclosures about the GGS are made in financial statements, those disclosures are to be made in accordance with the requirements prescribed in this Standard. This will ensure that an appropriate representation of the GGS is made in the financial statements and that disclosures about the GGS satisfy the qualitative characteristics of financial information, including understandability, relevance, reliability, and comparability.

14. IPSASs generally apply to all public sector entities. However, it is only possible to disclose a meaningful representation of the GGS for a government – not its individual controlled entities. Therefore, this Standard specifies requirements for application only by governments which prepare consolidated financial statements under the accrual basis of accounting as prescribed by IPSASs. These governments may include national, state/provincial and local governments.

Definitions

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

The <u>General Government Sector</u> comprises all organizational entities of the general government as defined in statistical bases of financial reporting.

<u>Government Business Enterprise</u> means an entity that has all the following characteristics:

(a) **Is an entity with the power to contract in its own name;**

(b) **Has been assigned the financial and operational authority to carry on a business;**

(c) **Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;**

(d) **Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and**

(e) **Is controlled by a public sector entity.**

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

Government Business Enterprises

16. GBEs include both trading enterprises, such as utilities, and financial enterprises, such as financial institutions. GBEs are, in substance, no different from entities conducting similar activities in the private sector. GBEs generally operate to make a profit, although some may have limited community service obligations under which they are required to provide some individuals and organizations in the community with goods and services at either no charge or a significantly reduced charge.

General Government Sector

17. Under statistical bases of financial reporting the public sector comprises the GGS, PFC and PNFC sector. Additional subgroups within these sectors may be identified for statistical analytical purposes.

18. The GGS is defined in the SNA 93 (and updates) as consisting of all resident central, state and local government units, social security funds at each level of government, and nonmarket nonprofit institutions controlled by government units. Under statistical bases of financial reporting, the GGS encompasses the central operations of government and typically includes all those resident nonmarket nonprofit entities that have their operations funded primarily by the government and government entities. As such, the financing of these entities is sourced primarily from appropriation or allocation of the government's taxes, dividends from government corporations, other revenues, and borrowings. The GGS typically includes entities such as government departments, law courts, public educational institutions, public health care units and other government agencies. The GGS does not include PFCs or PNFCs. Disclosure of GGS information will be made in those jurisdictions where strengthening the link between IPSASs and statistical bases of financial reporting is considered useful and relevant to users of financial statements. Governments electing to make GGS disclosures will therefore need to ensure that the information about the GGS included in the financial statements is consistent with the definition of GGS, and any interpretations thereof, adopted for statistical bases of financial reporting in their jurisdiction.

Public Financial Corporations Sector

19. The PFC sector comprises resident government controlled financial corporations, quasi-corporations and nonprofit institutions which primarily engage in financial intermediation and the provision of financial services for the market. Included within this sector are government controlled banks, including central banks, and other government financial institutions that operate on a market basis.

Public Non-Financial Corporations Sector

20. The PNFC sector comprises resident government controlled non-financial corporations, quasi-corporations and nonprofit institutions that produce goods or nonfinancial services for the market. Included within this sector are entities such as publicly owned utilities and other entities that trade in goods and services.

21. Statistical bases of financial reporting define:

    (a) Corporations as legal entities created for the purpose of producing goods and services for the market;

    (b) Quasi-corporations as enterprises that are not incorporated or otherwise legally established but function as if they were corporations; and

    (c) Nonprofit institutions as legal or other entities which produce or distribute goods and services, but which do not generate financial gain for their controlling entity.

22. A GBE as defined in this Standard has similar characteristics to a public corporation or public quasi-corporation as defined in statistical bases of financial reporting. However, there may not be an identical mapping of GBEs and the PFC and PNFC sectors. For example, a GBE that is not resident would not be classified as a PFC or a PNFC.

Accounting Policies

23. **Financial information about the GGS shall be disclosed in conformity with the accounting policies adopted for preparing and presenting the consolidated financial statements of the government, except as required by paragraphs 24 and 25.**

24. **In presenting financial information about the GGS, entities shall not apply the requirements of IPSAS 6 in respect of entities in the PFCs and public NFCS sectors.**

25. **The GGS shall recognize its investment in the PFC and public NFCS sectors as an asset and shall account for that asset at the carrying amount of the net assets of its investees.**

26. This Standard reflects the view that the consolidated financial statements of a government which elects to disclose information about the GGS are to be disaggregated to present the GGS as one sector of the government reporting entity. Consistent with this view, this Standard requires that the same definitions and the same recognition, measurement and presentation requirements that are applied when preparing the consolidated financial statements are also applied to the GGS disclosures, with one exception. That exception is that the requirements of IPSAS 6 are not applied in respect of the relationship of the GGS sector with entities in the PFC and PNFC sectors.

27. IPSAS 6 requires controlling entities to prepare financial statements that consolidate controlled entities on a line by line basis. IPSAS 6 also contains a detailed discussion of the concept of control as it applies in the public sector and guidance on determining whether control exists for financial reporting purposes. Consistent with the requirements of IPSAS 6, entities in the PFC and PNFC sectors as defined in statistical bases of financial reporting which are controlled entities of the government, will be consolidated in the government's financial statements.

28. Financial statements prepared consistent with statistical bases of financial reporting portray the impact of the GGS on the public sector as a whole and, in the context of the SNA 93 (and updates), on a national economy. Consistent with that focus, statistical bases of financial reporting require the GGS financial statements to present public sector entities outside that sector as investments in other sectors. In addition, under statistical bases of financial reporting, transactions of the GGS with entities in other sectors are not eliminated from the statement of government operations or a similar statement.

29. To apply the IPSAS 6 requirements for consolidation to the GGS would result in the re-presentation of the consolidated financial statements of a government, rather than the GGS financial statements.

30. Therefore, in disclosing financial information about the GGS, balances and transactions between entities within the GGS are eliminated in accordance with IPSAS 6. However, balances and transactions between entities in the GGS and entities in other sectors are not eliminated.

31. This Standard requires the GGS sector to recognize its investment in entities in the PFC or PNFC sectors at the carrying amount of the net assets of those entities. This will ensure that the GGS disclosures reflect a disaggregation of financial information presented in the consolidated financial statements of the government of which it is a part. Consistent with the GGS being a disaggregation of the consolidated financial statements of a government, changes in the carrying amount of the net assets of those entities will be recognized in the same manner as they are recognized in the consolidated financial statements of a government.

32. Statistical bases of reporting require all assets and liabilities (except loans) to be revalued to market value at each reporting date. IPSASs include different measurement requirements and require or permit cost and current values for certain classes of assets and liabilities. They do not require all assets and liabilities to be revalued to market value. Therefore, the measurement of assets and liabilities in the GGS disclosures in the financial statements, including the investment in the PFC and PNFC sectors, may differ from the measurement basis adopted in statistical bases of reporting.

Further Disaggregation

33. In some jurisdictions, national governments may control provincial and/or local governments and, consequently, the national government's financial statements will consolidate different levels of government. If financial statements consolidate different levels of government, further disaggregation of the consolidated financial statements may occur in accordance with the requirements of this Standard to separately disclose information about the GGS at each level of government.

34. This further disaggregation is not required by this Standard. However, it may be presented to further assist users to better understand the relationship between the GGS activities of each level of government consolidated in the financial statements, and the relationship between financial statements and the statistical bases of financial reporting in those jurisdictions.

Disclosures

35. **Disclosures made in respect of the GGS shall include at least of the following:**

    (a) **Assets by major class, showing separately the investment in other sectors;**

    (b) **Liabilities by major class;**

    (c) **Net assets/equity;**

    (d) **Total revaluation increments and decrements and other items of revenue and expense recognized directly in net assets/equity;**

    (e) **Revenue by major class;**

    (f) **Expenses by major class;**

    (g) **Surplus or deficit;**

    (h) **Cash flows from operating activities by major class;**

    (i) **Cash flows from investing activities; and**

    (j) **Cash flows from financing activities.**

The manner of presentation of the GGS disclosures shall be no more prominent than the government's financial statements prepared in accordance with IPSASs.

36. IPSAS 1, "Presentation of Financial Statements" identifies a complete set of financial statements (under the accrual basis) as a statement of financial position, statement of financial performance, statement of changes in net assets/equity, cash flow statement and accounting policies and notes to the financial statements.

37. This Standard requires disclosure of the major classes of assets, liabilities, revenues, expenses and cash flows reflected in the financial statements. This Standard does not specify the manner in which the GGS disclosures shall be made. Governments electing to make GGS disclosures in accordance with this Standard may make such disclosures by way of note disclosure, separate columns in the primary financial statements, or otherwise as considered appropriate in their jurisdiction. However, the manner of presentation of the GGS disclosures will be no more prominent than the consolidated financial statements prepared in accordance with IPSASs.

38. To assist users to understand the relationship of financial information presented for the GGS to a government's operations, statistical bases of financial reporting require total government expenses to be disaggregated and disclosed by class based on either the economic nature of the expenses or by the Classification of Functions of Government (COFOG). This Standard does not require nor prohibit entities disclosing GGS information from presenting disaggregated GGS information classified by economic nature or consistent with the COFOG classification basis. In some jurisdictions, the COFOG classifications adopted in respect of the GGS disclosures may be similar to the classifications adopted in accordance with IPSAS 18.

39. Entities will also make any additional disclosures that are necessary for users to understand the nature of the information presented.

40. **Entities preparing GGS disclosures shall disclose the significant controlled entities that are included in the GGS and any changes in those entities from the prior period, together with an explanation of the reasons why any such entity that was previously included in the GGS is no longer included.**

41. This Standard requires entities electing to disclose information about the GGS to disclose a list of the significant controlled entities that are included in the GGS. IPSAS 6 requires entities preparing consolidated financial statements to disclose a list of the significant controlled entities that are included in the consolidated financial statements. Disclosure of which of the entities consolidated in the financial statements in accordance with IPSAS 6 are included in the GGS will assist users in developing an understanding of the

relationship between information about the government and its GGS, and in better understanding the GGS information itself.

42. Similarly, disclosure of changes in the controlled entities included in the GGS will enable users to monitor the relationship between the consolidated financial statements and the GGS information over time.

Reconciliation to the Consolidated Financial Statements

43. **The GGS disclosures shall be reconciled to the consolidated financial statements of the government showing separately the amount of the adjustment to each equivalent item in those financial statements.**

44. This Standard requires the amounts disclosed in respect of the GGS to be reconciled to their equivalent amounts in the consolidated financial statements of the government. Entities will present separately the adjustment in the amount of the asset investment in PFC and PNFC sectors determined in accordance with paragraph 23 and adjustments to each of the items disclosed separately in accordance with paragraph 35. In addition, entities may, but are not required to, disclose separately the amount of the adjustment to each item attributable to the PFC and the PNFC sectors. This reconciliation will enable the government to better discharge its accountability obligations by demonstrating the relationship between the amounts of each item for the GGS with the total amount of that item for the government.

Reconciliation to Statistical Bases of Financial Reporting

45. Statistical bases of financial reporting and IPSASs have many similarities in their treatment of particular transactions and events. However, there are also differences. For example, in addition to differences in the measurement bases for assets and liabilities outlined in paragraph 32 above, statistical bases of financial reporting treat dividends as expenses while IPSASs treat them as distributions. Statistical bases of financial reporting also make a distinction between transactions and other economic flows for presentation of financial information that is not currently reflected in the consolidated financial statements, and focus on particular measures relevant for analysis of fiscal policy such as net lending/borrowing and cash surplus/deficit.

46. This Standard does not require a reconciliation of the GGS disclosures in the consolidated financial statements with the GGS disclosures under statistical bases of financial reporting. This is because of concerns about the practicability, and the costs and benefits, of such a requirement in all jurisdictions. However, the inclusion of such a reconciliation by way of note disclosure is not precluded.

Effective Date

47. **An entity that elects to disclose financial information about the GGS shall apply this IPSAS for annual financial statements covering periods beginning on or after January 1, 2008. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2008 it shall disclose that fact.**

48. When an entity adopts the accrual basis of accounting, as defined by IPSASs, for financial reporting purposes, subsequent to this effective date, this Standard applies to the entity's annual financial statements covering periods beginning on or after the date of adoption. In accordance with the requirements of IPSAS 1, the disclosure of comparative information is not required for the reporting period in which this Standard is first applied.

Implementation Guidance – Illustrative Financial Statement Structure

This guidance accompanies, but is not part of, IPSAS 22.

GOVERNMENT A – EXTRACT OF FINANCIAL STATEMENTS

Extract from the Notes to the Financial Statements

Note: General Government Sector (GGS) Disclosures

The following disclosures are made for the general government sector (GGS). They reflect the accounting policies adopted in the consolidated financial statements except that the consolidation requirements have been varied in respect of the public financial corporations (PFCs) sector and public nonfinancial corporations (PNFCs) sector. In accordance with the requirements of IPSAS 22, "Disclosure of Financial Information about the General Government Sector," PFCs and PNFCs are not consolidated in the GGS disclosures but are recognized as investments of the GGS. The investments in PFCs and PNFCs are presented as a single line item measured at the carrying amount of the net assets of the investees.

The GGS comprises all central government ministries and other entities controlled by the government that are primarily engaged in nonmarket activities. These entities are:

Ministry of x

y

z.

During the reporting period, activities related to the postal service, previously undertaken by the ministry of communications, have been reconstituted on a commercial basis and are no longer included in the financial information presented for the GGS.

STATEMENT OF FINANCIAL POSITION FOR THE GGS – AS AT DECEMBER 31, 20X2

(in thousands of currency units)

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1
ASSETS								
Current assets								
Cash and cash equivalents	X	X	X	X	(X)	(X)	X	X
Receivables	X	X	X	X	(X)	(X)	X	X
Inventories	X	X	X	X			X	X
Prepayments	X	X	X	X	(X)	(X)	X	X
Investment	X	X	X	X			X	X
Other current assets	X	X	X	X			X	X
	X	X	X	X	(X)	(X)	X	X
Non-current assets								
Receivables	X	X	X	X	(X)	(X)	X	X
Investments	X	X	X	X			X	X
Investment in other sectors	X	X			(X)	(X)		
Other financial assets	X	X	X	X	(X)	(X)	X	X
Infrastructure, plant and equipment	X	X	X	X			X	X
Land and buildings	X	X	X	X			X	X
Intangible assets	X	X	X	X			X	X
Other non-financial assets	X	X	X	X			X	X
	X	X	X	X	(X)	(X)	X	X
TOTAL ASSETS	X	X	X	X	(X)	(X)	X	X
LIABILITIES								
Current liabilities								
Payables	X	X	X	X	(X)	(X)	X	X
Short-term borrowings	X	X	X	X			X	X
Current portion of borrowings	X	X	X	X			X	X
Provisions	X	X	X	X			X	X
Employee benefits	X	X	X	X			X	X
Other current liabilities	X	X	X	X	(X)	(X)	X	X

	GGS		**PFC and PNFC**		**Eliminations**		**Total W-of-G**	
	20X2	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
	X	X	X	X	(X)	(X)	X	X
Non-current liabilities								
Payables	X	X	X	X	(X)	(X)	X	X
Borrowings	X	X	X	X			X	X
Provisions	X	X	X	X			X	X
Employee benefits	X	X	X	X			X	X
Other liabilities	X	X	X	X	(X)	(X)	X	X
	X	X	X	X	(X)	(X)	X	X
TOTAL LIABILITIES	X	X	X	X	(X)	(X)	X	X
NET ASSETS	X	X	X	X	(X)	(X)	X	X
NET ASSETS/EQUITY								
Reserves	X	X	X	X	(X)	(X)	X	X
Accumulated surpluses/ (deficits)	X	X	X	X	(X)	(X)	X	X
	X	X	X	X	(X)	(X)	X	X
TOTAL NET ASSETS/ EQUITY	X	X	X	X	(X)	(X)	X	X

STATEMENT OF FINANCIAL PERFORMANCE FOR THE GGS - FOR YEAR ENDED DECEMBER 31, 20X2 – CLASSIFICATION OF FUNCTION OF GOVERNMENT

(in thousands of currency units)

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1
Revenue								
Taxes	X	X			(X)	(X)	X	X
Fees, fines, penalties	X	X	X	X	(X)	(X)	X	X
Revenue from other sectors	X	X	X	X	(X)	(X)		
Transfers from other governments	X	X	X	X			X	X
Other operating revenue	X	X	X	X	(X)	(X)	X	X
Total revenue	X	X	X	X	(X)	(X)	X	X
Expenses								
General public services	X	X					X	X
Defense	X	X					X	X
Public order and safety	X	X	X	X			X	X
Economic affairs	X	X					X	X
Environmental protection	X	X	X	X	(X)	(X)	X	X
Housing and community amenities	X	X	X	X	(X)	(X)	X	X
Health	X	X	X	X			X	X
Recreational, cultural and religious	X	X					X	X
Education	X	X	X	X	(X)	(X)	X	X
Social protection	X	X	X	X	(X)	(X)	X	X
Total expenses	X	X	X	X	(X)	(X)	X	X
Surplus/(deficit) for the period	X	X	X	X	(X)	(X)	X	X

STATEMENT OF FINANCIAL PERFORMANCE FOR THE GGS - FOR YEAR ENDED DECEMBER 31, 20X2 – ECONOMIC CLASSIFICATION OF EXPENSE (Alternative presentation method)

(in thousands of currency units)

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1
Revenue								
Taxes	X	X			(X)	(X)	X	X
Fees, fines, penalties	X	X	X	X	(X)	(X)	X	X
Revenue from other sectors	X	X	X	X	(X)	(X)		
Transfers from other governments	X	X	X	X			X	X
Other operating revenue	X	X	X	X	(X)	(X)	X	X
Total revenue	X	X	X	X	(X)	(X)	X	X
Expenses								
Compensation of Employees	X	X	X	X	(X)	(X)	X	X
Use of Goods and Services	X	X	X	X	(X)	(X)	X	X
Consumption of Fixed Capital	X	X	X	X	(X)	(X)	X	X
Interest	X	X	X	X	(X)	(X)	X	X
Subsidies	X	X	X	X	(X)	(X)	X	X
Social Benefits	X	X	X	X	(X)	(X)	X	X
Other Expense	X	X	X	X			X	X
Total expenses	X	X	X	X	(X)	(X)	X	X
Surplus/(deficit)	X	X	X	X	(X)	(X)	X	X

PUBLIC SECTOR

STATEMENT OF CHANGES IN NET ASSETS/EQUITY FOR THE GGS - FOR THE YEAR ENDED DECEMBER 31, 20X2

(in thousands of currency units)

	GGS					
	Revaluation Reserve	**Translation Reserve**	**Accumulated Surpluses/ (Deficits)**	**PFC and PNFC**	**Eliminations**	**Total W-of-G**
Balance at December 31, 20X0	X	(X)	X	X	X	X
Surplus on revaluation of property	X			X		X
Deficit on revaluation of investments	(X)			(X)	X	(X)
Currency translation differences		(X)		(X)		(X)
Net gains and losses not recognized in the statement of financial performance	X	(X)		X	(X)	X
Net surplus for the period			X	X	(X)	X
Balance at December 31, 20X1	X	(X)	X	X	(X)	X
Deficit on revaluation of property	(X)			(X)	X	(X)
Surplus on revaluation of investments	X			X	(X)	X
Currency translation differences		(X)		X		X
Net gains and losses not recognized in the statement of financial performance	(X)	(X)		(X)	(X)	(X)
Net deficit for the period			(X)	(X)	(X)	(X)
Balance at December 31, 20X2	X	(X)	X	X	(X)	X

CASH FLOW STATEMENT FOR THE GGS - FOR YEAR ENDED DECEMBER 31, 20X2

(in thousands of currency units)

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	20X1	20X2	20X1	20X2	20X1	20X2	20X1
CASH FLOWS FROM OPERATING ACTIVITIES								
Receipts								
Taxation	X	X			(X)	(X)	X	X
Sales of goods and services			X	X	(X)	(X)	X	X
Grants			X	X	(X)	(X)	X	X
Interest received			X	X			X	X
Dividends from other sectors to government	X	X			(X)	(X)		
Other receipts	X	X	X	X	(X)	(X)	X	X
Payments								
Employee costs	(X)	(X)	(X)	(X)			(X)	(X)
Retirement Benefits	(X)	(X)	(X)	(X)			(X)	(X)
Suppliers	(X)	(X)	(X)	(X)			(X)	(X)
Interest paid	(X)	(X)	(X)	(X)			(X)	(X)
Dividend to other sectors			(X)	(X)	X	X		
Other payments	(X)	(X)	(X)	(X)	X	X	(X)	(X)
Net cash flows from operating activities	X	X	X	X	(X)	(X)	X	X
CASH FLOWS FROM INVESTING ACTIVITIES								
Purchase of plant and equipment	(X)	(X)	(X)	(X)			(X)	(X)
Proceeds from sale of plant and equipment	X	X	X	X			X	X
Proceeds from sale of investments	X	X	X	X			X	X
Purchase of foreign currency securities	(X)	(X)	(X)	(X)			(X)	(X)
Net cash flows from investing activities	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
CASH FLOWS FROM FINANCING ACTIVITIES								

	GGS		PFC and PNFC		Eliminations		Total W-of-G	
	20X2	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**	**20X2**	**20X1**
Proceeds from borrowings	X	X	X	X			X	X
Repayment of borrowings	(X)	(X)	(X)	(X)			(X)	(X)
Net cash flows from financing activities	X	X	X	X	(X)	(X)	X	X
NET INCREASE/(DECREASE) IN CASH AND CASH EQUIVALENTS	X	X	X	X	(X)	(X)	X	X
CASH AND CASH EQUIVALENTS AT BEGINNING OF PERIOD	X	X	X	X	(X)	(X)	X	X
Cash and cash equivalents at end of period	X	X	X	X	(X)	(X)	X	X

Basis for Conclusions

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

Introduction

BC1. The *System of National Accounts* (SNA 93) (and updates), *Government Finance Statistics Manual* (GFSM) 2001, and the *European System of Accounts* (ESA 95), all require governments to publish financial information about the GGS. For statistical purposes, the GGS comprises government controlled entities primarily engaged in nonmarket activities. The GGS is sometimes described as comprising those entities that fulfill the core functions of government as their primary activity. The GGS does not include public corporations, even when all the equity of such corporations is owned by the government or government entities.

BC2. Current IPSASs do not require entities to disclose information about the GGS in their financial statements. IPSASs require entities to prepare financial statements that include information about all the resources controlled by the reporting entity, and prescribe rules for consolidation of all controlled entities. IPSAS 18, "Segment Reporting" also requires entities to identify segments and present information about those segments.

BC3. Some governments prepare, present and widely publish both financial statements and information about the financial characteristics and performance of the public sector prepared in accordance with statistical bases of reporting.

BC4. The IPSASB supports the convergence of IPSASs with statistical bases of reporting where appropriate. The statistical community encouraged the IPSASB to develop an IPSAS addressing the presentation of GGS information as part of a government's consolidated financial statements as a means of facilitating convergence.

BC5. The disclosure of GGS information can provide useful information to users of financial statements, particularly in those jurisdictions in which national or other governments, publish both financial statements in accordance with IPSASs and financial information in accordance with statistical bases of financial reporting. The IPSASB is also of the view that the disclosure of such information can assist users in better understanding the relationship between the market and nonmarket activities of the government. However, the IPSASB is not persuaded that the benefits of making such disclosures may be significantly greater than their costs in those jurisdictions where financial statements prepared in accordance with statistical bases of financial reporting are not routinely prepared and made publicly available. Consequently, these disclosures are not mandatory.

BC6. This Standard specifies requirements for application only by governments. This is because it is only possible to disclose a meaningful representation of the GGS for a government as a whole. In some jurisdictions, national governments may control provincial and/or local governments. Where this occurs, the financial statements may be further disaggregated to separately disclose information about the GGS for each level of government. Such disclosure is likely to assist users to better understand the relationship between the GGS activities of each level of government. However, in some jurisdictions, such disclosures may impose additional pressure on the accounting system and those responsible for data collection and aggregation, and it is not clear that the benefits of such disclosure for users of the financial statements will exceed their cost. Therefore, this Standard does not require entities that elect to disclose information about the GGS to also disclose separately information about the GGS of each level of government consolidated in the financial statements. However, such disclosures are not precluded.

Consolidation and Disaggregation

BC7. Statistical bases of financial reporting and IPSASs have many similarities in their treatment of particular transactions and events. However, there are also differences. For example, statistical bases of financial reporting:

(a) Require all assets and liabilities (except loans) to be revalued to market value at each reporting date. IPSASs include different measurement requirements, and require or permit cost and current values for certain classes of assets and liabilities;

(b) Treat dividends as expenses while IPSASs treat them as distributions;

(c) Make a distinction between transactions and other economic flows for presentation of financial information. IPSASs do not currently make a similar distinction; and

(d) Focus on the presentation of financial information about the GGS and the other sectors of the public sector as separate components and, in this context, adopt the same rules for recognition and measurement as are adopted for presentation of the rest of the economy to ensure consistency of the macro-economic totals. Under statistical bases of financial reporting, financial statements prepared for the GGS do not include consolidation of PNFCs, being government controlled entities that trade in goods and services, and PFCs such as banks. The IPSASs focus on consolidated financial statements which present financial information about all the assets, liabilities, revenues, expenses and cash flows controlled by the entity.

BC8. This Standard requires that the disclosure of information about the GGS be a disaggregation of a government's consolidated financial statements. This is a similar perspective that is adopted for disclosure of segment information in accordance with IPSAS 18. Accordingly, the same accounting policies as those adopted for the consolidated financial statements are to be adopted in making GGS disclosures with one exception as noted below.

BC9. When GGS disclosures are made in financial statements, the requirements of IPSAS 6 should not be applied in respect of PFCs and PNFCs. This is because the application of IPSAS 6 to the PFC and PNFC sectors would result in the re-presentation of a government's consolidated financial statements rather than the GGS financial statements. This would defeat the purpose of the disclosure of GGS information as a bridge between financial statements prepared in accordance with IPSASs and those prepared in accordance with statistical bases of financial reporting.

Segment Reporting

BC10. IPSAS 18 requires the separate disclosure of certain information about significant activities or groups of activities for the evaluation of the performance of the entity in achieving its objectives, and for decision-making purposes. IPSAS 18 does not distinguish between exchange and non-exchange transactions and events, or market and nonmarket activity of government. Rather, its focus is on the disclosure of the revenues, expenses, assets and liabilities associated with the delivery of major services or groups of services – whether these services are delivered by the GGS of the government or by PFCs and PNFCs. The objective of segment reporting is not achieved by the disclosure of information about the GGS. Accordingly, a government electing to disclose information about the GGS needs also to disclose information about segments.

BC11. Statistical bases of financial reporting present information about expenses or expenditure of the government classified either by economic nature or the COFOG. Either of these classification bases may be applied to disclose additional information about the GGS. In some cases a COFOG classification may be adopted to disclose segment information in a government's consolidated financial statements.

Reconciliation

BC12. The information disclosed about the GGS in accordance with the requirements of this Standard may differ in content and form from that presented under statistical bases of financial reporting.

BC13. The IPSASB considered whether those governments which elect to disclose information about the GGS in accordance with this Standard should be required to disclose a reconciliation of the GGS disclosures in the financial statements and the GGS disclosures under statistical bases of financial reporting. The IPSASB was concerned that such a requirement may impose significant costs on the preparer and that those costs may be greater than the benefits in some jurisdictions. This would then discourage governments which might otherwise elect to make such disclosures. Of particular concern to the IPSASB in this respect was, for example, whether the:

(a) Timing of compilation of financial statements and statistical information is such that a reconciliation could be completed within the timeframe necessary for the financial statements to be audited and signed off or authorized for issue in accordance with legislative requirements and/or requirements of the IPSASs;

(b) Inclusion of such a requirement would trigger an audit of the reconciliation and may also trigger an audit of the statistical reports themselves; and

(c) Entity may be required to remeasure and reclassify assets, liabilities, revenues and expenses in accordance with the requirements of the statistical bases of financial reporting, and whether this would discourage disclosure of the GGS information.

BC14. On balance, the IPSASB concluded that such a reconciliation should not be required at this stage. However, a reconciliation of the GGS disclosures presented in accordance with the requirements of this Standard to the equivalent items in the financial statements of the government prepared in accordance with the requirements of IPSASs is consistent with enhanced transparency, is not onerous and would be useful to users. The disclosure of a reconciliation of the GGS disclosures presented in accordance with the requirements of this Standard and the GGS disclosures presented under statistical bases of financial reporting is not prohibited.

IPSAS 23—REVENUE FROM NON-EXCHANGE TRANSACTIONS (TAXES AND TRANSFERS)

CONTENTS

Exchange Transactions (Taxes and Transfers)" is set out in paragraphs 1–125. All the paragraphs have equal authority except as noted otherwise. IPSAS 23 should be read in the context of its objective, the Basis for Conclusions, and the "Preface to International Public Sector Accounting Standards." IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1. The International Public Sector Accounting Standards Board (IPSASB) decided to develop an International Public Sector Accounting Standard (IPSAS) on revenue from non-exchange transactions because:

(a) Non-exchange revenues (taxes and transfers) form the majority of revenue for most public sector entities; and

(b) Until now there has been no generally accepted international financial reporting standard that addresses the recognition and measurement of taxation revenue.

IN2. The IPSASB's predecessor organization, the Public Sector Committee (PSC), established a Steering Committee in 2002 to carry out initial work on accounting and financial reporting of revenue from non-exchange transactions by public sector entities. In January 2004, the PSC published an Invitation to Comment (ITC), prepared by the Steering Committee, "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)." The ITC requested comments by June 30, 2004.

IN3. The IPSASB reviewed comments and drafted an Exposure Draft at its November 2004 and subsequent meetings, and issued a final Exposure Draft in January 2006, with a request for comments by June 30, 2006. At its November 2006 meeting, the IPSASB reviewed the comments received and approved this IPSAS for issue.

Main Features of the IPSAS

IN4. The IPSAS:

(a) Takes a transactional analysis approach whereby entities are required to analyze inflows of resources from non-exchange transactions to determine if they meet the definition of an asset and the criteria for recognition as an asset, and if they do, determine whether a liability is also required to be recognized;

(b) Requires that assets recognized as a result of a non-exchange transaction initially be measured at their fair value as at the date of acquisition;

(c) Requires that liabilities recognized as a result of a non-exchange transaction be recognized in accordance with the principles established in IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets";

(d) Requires that revenue equal to the increase in net assets associated with an inflow of resources be recognized;

(e) Provides specific guidance that addresses:

i. Taxes; and

ii. Transfers, including:

1. Debt forgiveness and assumption of liabilities;
2. Fines;
3. Bequests;
4. Gifts and Donations, including goods in-kind;
5. Services in-kind;

(f) Permits, but does not require, the recognition of services in-kind; and

(g) Requires disclosures to be made in respect of revenue from non-exchange transactions.

Amendments to Other IPSASs

IN5. The Standard amends IPSASs 1, "Presentation of Financial Statements," 12, "Inventories," 16, "Investment Property" and 17, "Property, Plant and Equipment." The amended IPSASs will require that inventories, investment property or property, plant and equipment acquired through a non-exchange transaction be initially measured at the fair value of the item as at the date of acquisition.

IPSAS 23—REVENUE FROM NON-EXCHANGE TRANSACTIONS (TAXES AND TRANSFERS)

Objective

1. The objective of this Standard is to prescribe requirements for the financial reporting of revenue arising from non-exchange transactions, other than non-exchange transactions that give rise to an entity combination. The Standard deals with issues that need to be considered in recognizing and measuring revenue from non-exchange transactions including the identification of contributions from owners.

Scope

2. **An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for revenue from non-exchange transactions. This Standard does not apply to an entity combination that is a non-exchange transaction.**

3. **This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).**

4. This Standard addresses revenue arising from non-exchange transactions. Revenue arising from exchange transactions is addressed in IPSAS 9, "Revenue from Exchange Transactions." While revenues received by public sector entities arise from both exchange and non-exchange transactions, the majority of revenue of governments and other public sector entities is typically derived from non-exchange transactions such as:

   (a) Taxes; and

   (b) Transfers (whether cash or noncash), including grants, debt forgiveness, fines, bequests, gifts, donations, and goods and services in-kind.

5. Governments may reorganize the public sector, merging some public sector entities and dividing other entities into two or more separate entities. An entity combination occurs when two or more reporting entities are brought together to form one reporting entity. These restructurings do not ordinarily involve one entity purchasing another entity, but may result in a new or existing entity acquiring all the assets and liabilities of another entity. The IPSASB has not addressed entity combinations and has excluded them from the scope of this Standard. Therefore, this Standard does not specify whether an entity combination, which is a non-exchange transaction, will give rise to revenue or not.

Government Business Enterprises

6. The "Preface to International Public Sector Accounting Standards" issued by the IPSASB explains that International Financial Reporting Standards (IFRSs) are designed to apply to the general purpose financial statements of all profit-oriented entities. GBEs are profit-oriented entities and accordingly are required to comply with IFRSs.

Definitions

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

Conditions on transferred assets are stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.

Control of an asset arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.

Exchange transactions are transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.

Expenses paid through the tax system are amounts that are available to beneficiaries regardless of whether or not they pay taxes.

Fines are economic benefits or service potential received or receivable by public sector entities, as determined by a court or other law enforcement body, as a consequence of the breach of laws or regulations.

Non-exchange transactions are transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.

Restrictions on transferred assets are stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified.

Stipulations on transferred assets are terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.

Tax expenditures are preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.

The taxable event is the event that the government, legislature or other authority has determined will be subject to taxation.

Taxes are economic benefits or service potential compulsorily paid or payable to public sector entities, in accordance with laws and or regulations, established to provide revenue to the government. Taxes do not include fines or other penalties imposed for breaches of the law.

Transfers are inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.

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

Non-Exchange Transactions

8. In some transactions it is clear that there is an exchange of approximately equal value. These are exchange transactions and are addressed in other IPSASs.

9. In other transactions an entity will receive resources and provide no or nominal consideration directly in return. These are clearly non-exchange transactions and are addressed in this Standard. For example, taxpayers pay taxes because the tax law mandates the payment of those taxes. Whilst the taxing government will provide a variety of public services to taxpayers, it does not do so in consideration for the payment of taxes.

10. There is a further group of non-exchange transactions where the entity may provide some consideration directly in return for the resources received, but that consideration does not approximate the fair value of the resources received. In these cases the entity determines whether there is a combination of exchange and non-exchange transactions, each component of which is recognized separately.

11. There are also additional transactions where it is not immediately clear whether they are exchange or non-exchange transactions. In these cases an examination of the substance of the transaction will determine if they are exchange or non-exchange transactions. For example, the sale of goods is normally classified as an exchange transaction. If, however, the transaction is conducted at a subsidized price, that is, a price that is not approximately equal to the fair value of the goods sold, that transaction falls within the definition of a non-exchange transaction. In determining whether the substance of a transaction is that of a non-exchange or an exchange transaction, professional judgment is exercised. In addition, entities may receive trade discounts, quantity discounts, or other reductions in the quoted price of assets for a

variety of reasons. These reductions in price do not necessarily mean that the transaction is a non-exchange transaction.

Revenue

12. Revenue comprises gross inflows of economic benefits or service potential received and receivable by the reporting entity, which represents an increase in net assets/equity, other than increases relating to contributions from owners. Amounts collected as an agent of the government or another government organization or other third parties will not give rise to an increase in net assets or revenue of the agent. This is because the agent entity cannot control the use of, or otherwise benefit from, the collected assets in the pursuit of its objectives.

13. Where an entity incurs some cost in relation to revenue arising from a non-exchange transaction, the revenue is the gross inflow of future economic benefits or service potential, and any outflow of resources is recognized as a cost of the transaction. For example, if a reporting entity is required to pay delivery and installation costs in relation to the transfer of an item of plant to it from another entity, those costs are recognized separately from revenue arising from the transfer of the item of plant. Delivery and installation costs are included in the amount recognized as an asset, in accordance with IPSAS 17.

Stipulations

14. Assets may be transferred with the expectation and or understanding that they will be used in a particular way and, therefore, that the recipient entity will act or perform in a particular way. Where laws, regulations or binding arrangements with external parties impose terms on the use of transferred assets by the recipient, these terms are stipulations as defined in this IPSAS. A key feature of stipulations, as defined in this Standard, is that an entity cannot impose a stipulation on itself, whether directly or through an entity that it controls.

15. Stipulations relating to a transferred asset may be either conditions or restrictions. While conditions and restrictions may require an entity to use or consume the future economic benefits or service potential embodied in an asset for a particular purpose (performance obligation) on initial recognition, only conditions require that future economic benefits or service potential be returned to the transferor in the event that the stipulation is breached (return obligation).

16. Stipulations are enforceable through legal or administrative processes. If a term in laws or regulations or other binding arrangements is unenforceable, it is not a stipulation as defined by this Standard. Constructive obligations do not arise from stipulations. IPSAS 19 establishes requirements for the recognition and measurement of constructive obligations.

Conditions on Transferred Assets

17. Conditions on transferred assets (hereafter referred to as conditions) require that the entity either consume the future economic benefits or service potential of the asset as specified or return future economic benefits or service potential to the transferor in the event that the conditions are breached. Therefore, the recipient incurs a present obligation to transfer future economic benefits or service potential to third parties when it initially gains control of an asset subject to a condition. This is because the recipient is unable to avoid the outflow of resources as it is required to consume the future economic benefits or service potential embodied in the transferred asset in the delivery of particular goods or services to third parties or else to return to the transferor future economic benefits or service potential. Therefore, when a recipient initially recognizes an asset that is subject to a condition, the recipient also incurs a liability.

18. As an administrative convenience, a transferred asset, or other future economic benefits or service potential, may be effectively returned by deducting the amount to be returned from other assets due to be transferred for other purposes. The reporting entity will still recognize the gross amounts in its financial statements, that is, the entity will recognize a reduction in assets and liabilities for the return of the asset under the terms of the breached condition, and will reflect the recognition of assets, liabilities and or revenue for the new transfer.

Restrictions on Transferred Assets

19. Restrictions on transferred assets (hereafter referred to as restrictions) do not include a requirement that the transferred asset, or other future economic benefits or service potential is to be returned to the transferor if the asset is not deployed as specified. Therefore, gaining control of an asset subject to a restriction does not impose on the recipient a present obligation to transfer future economic benefits or service potential to third parties when control of the asset is initially gained. Where a recipient is in breach of a restriction, the transferor, or another party, may have the option of seeking a penalty against the recipient, by, for example, taking the matter to a court or other tribunal, or through an administrative process such as a directive from a government minister or other authority, or otherwise. Such actions may result in the entity being directed to fulfil the restriction or face a civil or criminal penalty for defying the court, other tribunal or authority. Such a penalty is not incurred as a result of acquiring the asset, but as a result of breaching the restriction.

Substance over Form

20. In determining whether a stipulation is a condition or a restriction it is necessary to consider the substance of the terms of the stipulation and not merely its form. The mere specification that, for example, a transferred asset is required to be consumed in providing goods and services to third parties or

be returned to the transferor is, in itself, not sufficient to give rise to a liability when the entity gains control of the asset.

21. In determining whether a stipulation is a condition or restriction, the entity considers whether a requirement to return the asset or other future economic benefits or service potential is enforceable and would be enforced by the transferor. If the transferor could not enforce a requirement to return the asset or other future economic benefits or service potential, the stipulation fails to meet the definition of a condition and will be considered a restriction. If past experience with the transferor indicates that the transferor never enforces the requirement to return the transferred asset or other future economic benefits or service potential when breaches have occurred, then the recipient entity may conclude that the stipulation has the form but not the substance of a condition, and is, therefore, a restriction. If the entity has no experience with the transferor, or has not previously breached stipulations that would prompt the transferor to decide whether to enforce a return of the asset or other future economic benefits or service potential, and it has no evidence to the contrary, it would assume that the transferor would enforce the stipulation and, therefore, the stipulation meets the definition of a condition.

22. The definition of a condition imposes on the recipient entity a performance obligation – that is, the recipient is required to consume the future economic benefits or service potential embedded in the transferred asset as specified, or return the asset or other future economic benefits or service potential to the transferor. To satisfy the definition of a condition, the performance obligation will be one of substance not merely form and is required as a consequence of the condition itself. A term in a transfer agreement that requires the entity to perform an action that it has no alternative but to perform, may lead the entity to conclude that the term is in substance neither a condition nor a restriction. This is because in these cases, the terms of the transfer itself do not impose on the recipient entity a performance obligation.

23. To satisfy the criteria for recognition as a liability it is necessary that an outflow of resources will be probable and performance against the condition is required and is able to be assessed. Therefore, a condition will need to specify such matters as the nature or quantity of the goods and services to be provided or the nature of assets to be acquired as appropriate and, if relevant, the periods within which performance is to occur. In addition, performance will need to be monitored by, or on behalf of, the transferor on an ongoing basis. This is particularly so where a stipulation provides for a proportionate return of the equivalent value of the asset if the entity partially performs the requirements of the condition, and the return obligation has been enforced if significant failures to perform have occurred in the past.

24. In some cases, an asset may be transferred subject to the stipulation that it be returned to the transferor if a specified future event does not occur. This may occur where, for example, a national government provides funds to a

provincial government entity subject to the stipulation that the entity raise a matching contribution. In these cases, a return obligation does not arise until such time as it is expected that the stipulation will be breached and a liability is not recognized until the recognition criteria have been satisfied.

25. However, recipients will need to consider whether these transfers are in the nature of an advance receipt. In this Standard advance receipt refers to resources received prior to a taxable event or a transfer arrangement becoming binding. Advance receipts give rise to an asset and a present obligation because the transfer arrangement has not yet become binding. Where such transfers are in the nature of an exchange transaction, they will be dealt with in accordance with IPSAS 9.

Taxes

26. Taxes are the major source of revenue for many governments and other public sector entities. Taxes are defined in paragraph 7 as economic benefits compulsorily paid or payable to public sector entities, in accordance with laws or regulation, established to provide revenue to the government, excluding fines or other penalties imposed for breaches of laws or regulation. Noncompulsory transfers to the government or public sector entities such as donations and the payment of fees are not taxes, although they may be the result of non-exchange transactions. A government levies taxation on individuals and other entities, known as taxpayers, within its jurisdiction by use of its sovereign powers.

27. Tax laws and regulations can vary significantly from jurisdiction to jurisdiction, but they have a number of common characteristics. Tax laws and regulations establish a government's right to collect the tax, identify the basis on which the tax is calculated, and establish procedures to administer the tax, that is, procedures to calculate the tax receivable and ensure payment is received. Tax laws and regulations often require taxpayers to file periodic returns to the government agency that administers a particular tax. The taxpayer generally provides details and evidence of the level of activity subject to tax, and the amount of tax receivable by the government is calculated. Arrangements for receipt of taxes vary widely but are normally designed to ensure that the government receives payments on a regular basis without resorting to legal action. Tax laws are usually rigorously enforced and often impose severe penalties on individuals or other entities breaching the law.

28. Advance receipts, being amounts received in advance of the taxable event, may also arise in respect of taxes.

Analysis of the Initial Inflow of Resources from Non-Exchange Transactions

29. An entity will recognize an asset arising from a non-exchange transaction when it gains control of resources that meet the definition of an asset and satisfy the

recognition criteria. In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset, the entity decreases the carrying amount of the liability. In some cases, gaining control of the asset may also carry with it obligations that the entity will recognize as a liability. Contributions from owners do not give rise to revenue, so each type of transaction is analyzed and any contributions from owners are accounted for separately. Consistent with the approach set out in this Standard, entities will analyze non-exchange transactions to determine which elements of general purpose financial statements will be recognized as a result of the transactions. The flow chart on the following page illustrates the analytic process an entity undertakes when there is an inflow of resources to determine whether revenue arises.[1] This Standard follows the structure of the flowchart. Requirements for the treatment of transactions are set out in paragraphs 30 to 115.

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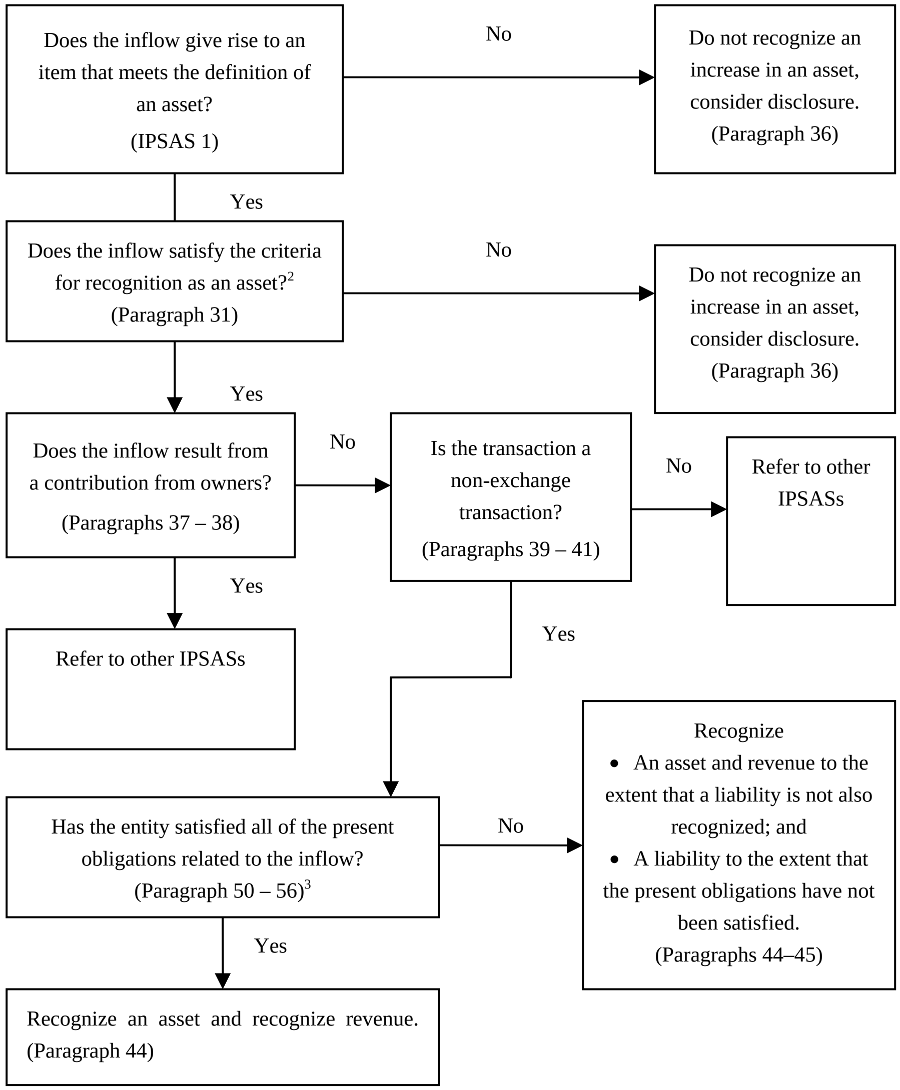
1 The flowchart is illustrative only, it does not take the place of the Standards. It is provided as an aid to interpreting the IPSAS.

Illustration of the Analysis of Initial Inflows of Resources[1]



1. The flowchart is illustrative only, it does not take the place of the Standards. It is provided as an aid to interpreting the IPSAS.
2. In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset the entity decreases the carrying amount of the liability.
3. In determining whether the entity has satisfied all of the present obligations, the application of the definition of conditions on a transferred asset, and the criteria for recognizing a liability are considered.

Recognition of Assets

30. Assets are defined in IPSAS 1, "Presentation of Financial Statements" as resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.

31. **An inflow of resources from a non-exchange transaction, other than services in-kind, that meets the definition of an asset shall be recognized as an asset when, and only when:**

    (a) **It is probable that the future economic benefits or service potential associated with the asset will flow to the entity; and**

    (b) **The fair value of the asset can be measured reliably.**

Control of an Asset

32. The ability to exclude or regulate the access of others to the benefits of an asset is an essential element of control that distinguishes an entity's assets from those public goods that all entities have access to and benefit from. In the public sector, governments exercise a regulatory role over certain activities, for example financial institutions or pension funds. This regulatory role does not necessarily mean that such regulated items meet the definition of an asset of the government, or satisfy the criteria for recognition as an asset in the general purpose financial statements of the government that regulates those assets. In accordance with paragraph 98, entities may, but are not required, to recognize services in-kind.

33. An announcement of an intention to transfer resources to a public sector entity is not of itself sufficient to identify resources as controlled by a recipient. For example, if a public school were destroyed by a forest fire and a government announced its intention to transfer funds to rebuild the school, the school would not recognize an inflow of resources (resources receivable) at the time of the announcement. In circumstances where a transfer agreement is required before resources can be transferred, a recipient entity will not identify resources as controlled until such time as the agreement is binding because the recipient entity cannot exclude or regulate the access of the transferor to the resources. In many instances, the entity will need to establish enforceability of its control of resources before it can recognize an asset. If an entity does not have an enforceable claim to resources, it cannot exclude or regulate the transferor's access to those resources.

Past Event

34. Public sector entities normally obtain assets from governments, other entities including taxpayers, or by purchasing or producing them. Therefore the past event which gives rise to control of an asset may be a purchase, a taxable event, or a transfer. Transactions or events expected to occur in the future do not in themselves give rise to assets – hence for example, an intention to levy

taxation is not a past event that gives rise to an asset in the form of a claim against a taxpayer.

Probable Inflow of Resources

35. An inflow of resources is probable when the inflow is more likely than not to occur. The entity bases this determination on its past experience with similar types of flows of resources and its expectations regarding the taxpayer or transferor. For example, where a government agrees to transfer funds to a public sector entity (reporting entity), the agreement is binding and the government has a history of transferring agreed resources, it is probable that the inflow will occur, notwithstanding that the funds have not been transferred at the reporting date.

Contingent Assets

36. An item that possesses the essential characteristics of an asset, but fails to satisfy the criteria for recognition may warrant disclosure in the notes as a contingent asset (see IPSAS 19).

Contributions from Owners

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

38. A contribution from owners may be evidenced by, for example:

    (a) A formal designation of the transfer (or a class of such transfers) by the contributor or a controlling entity of the contributor as forming part of the recipient's contributed net assets/equity, either before the contribution occurs or at the time of the contribution;

    (b) A formal agreement, in relation to the contribution, establishing or increasing an existing financial interest in the net assets/equity of the recipient which can be sold, transferred or redeemed; or

    (c) The issuance, in relation to the contribution, of equity instruments which can be sold, transferred or redeemed.

Exchange and Non-Exchange Components of a Transaction

39. Paragraphs 40 and 41 below address circumstances in which an entity gains control of resources embodying future economic benefits or service potential other than by contributions from owners.

40. Paragraph 7 defines exchange transactions and non-exchange transactions and paragraph 10 notes that a transaction may include two components, an exchange component and a non-exchange component.

41. Where an asset is acquired by means of a transaction that has an exchange component and a non-exchange component, the entity recognizes the exchange component according to the principles and requirements of other IPSASs. The non-exchange component is recognized according to the principles and requirements of this Standard. In determining whether a transaction has identifiable exchange and non-exchange components, professional judgment is exercised. Where it is not possible to distinguish separate exchange and non-exchange components, the transaction is treated as a non-exchange transaction.

Measurement of Assets on Initial Recognition

42. **An asset acquired through a non-exchange transaction shall initially be measured at its fair value as at the date of acquisition.**

43. Consistent with IPSAS 12, IPSAS 16, and IPSAS 17, assets acquired through non-exchange transactions are measured at their fair value as at the date of acquisition.

Recognition of Revenue from Non-Exchange Transactions

44. **An inflow of resources from a non-exchange transaction recognized as an asset shall be recognized as revenue, except to the extent that a liability is also recognized in respect of the same inflow.**

45. **As an entity satisfies a present obligation recognized as a liability in respect of an inflow of resources from a non-exchange transaction recognized as an asset, it shall reduce the carrying amount of the liability recognized and recognize an amount of revenue equal to that reduction.**

46. When an entity recognizes an increase in net assets as a result of a non-exchange transaction, it recognizes revenue. If it has recognized a liability in respect of the inflow of resources arising from the non-exchange transaction, when the liability is subsequently reduced, because the taxable event occurs or a condition is satisfied, it recognizes revenue. If an inflow of resources satisfies the definition of contributions from owners, it is not recognized as a liability or revenue.

47. The timing of revenue recognition is determined by the nature of the conditions and their settlement. For example, if a condition specifies that the

entity is to provide goods or services to third parties, or return unused funds to the transferor, revenue is recognized as goods or services are provided.

Measurement of Revenue from Non-Exchange Transactions

48. **Revenue from non-exchange transactions shall be measured at the amount of the increase in net assets recognized by the entity.**

49. When, as a result of a non-exchange transaction, an entity recognizes an asset, it also recognizes revenue equivalent to the amount of the asset measured in accordance with paragraph 42, unless it is also required to recognize a liability. Where a liability is required to be recognized it will be measured in accordance with the requirements of paragraph 57, and the amount of the increase in net assets, if any, recognized as revenue. When a liability is subsequently reduced, because the taxable event occurs, or a condition is satisfied, the amount of the reduction in the liability will be recognized as revenue.

Present Obligations Recognized as Liabilities

50. **A present obligation arising from a non-exchange transaction that meets the definition of a liability shall be recognized as a liability when, and only when:**

    (a) **It is probable that an outflow of resources embodying future economic benefits or service potential will be required to settle the obligation; and**

    (b) **A reliable estimate can be made of the amount of the obligation.**

Present Obligation

51. A present obligation is a duty to act or perform in a certain way and may give rise to a liability in respect of any non-exchange transaction. Present obligations may be imposed by stipulations in laws or regulations or binding arrangements establishing the basis of transfers. They may also arise from the normal operating environment, such as the recognition of advance receipts.

52. In many instances, taxes are levied and assets are transferred to public sector entities in non-exchange transactions pursuant to laws, regulation or other binding arrangements that impose stipulations that they be used for particular purposes. For example:

    (a) Taxes, the use of which is limited by laws or regulations to specified purposes;

    (b) Transfers, established by a binding arrangement that includes conditions:

        (i) From national governments to provincial, state or local governments;

(ii) From state/provincial governments to local governments;

(iii) From governments to other public sector entities;

(iv) To governmental agencies that are created by laws or regulation to perform specific functions with operational autonomy, such as statutory authorities or regional boards or authorities; and

(v) From donor agencies to governments or other public sector entities.

53. In the normal course of operations, a reporting entity may accept resources prior to a taxable event occurring. In such circumstances, a liability of an amount equal to the amount of the advance receipt is recognized until the taxable event occurs.

54. If a reporting entity receives resources prior to the existence of a binding transfer arrangement, it recognizes a liability for an advance receipt until such time as the arrangement becomes binding.

Conditions on a Transferred Asset

55. **Conditions on a transferred asset give rise to a present obligation on initial recognition that will be recognized in accordance with paragraph 50.**

56. Stipulations are defined in paragraph 7. Paragraphs 14–25 provide guidance on determining whether a stipulation is a condition or a restriction. An entity analyzes any and all stipulations attached to an inflow of resources, to determine whether those stipulations impose conditions or restrictions.

Measurement of Liabilities on Initial Recognition

57. **The amount recognized as a liability shall be the best estimate of the amount required to settle the present obligation at the reporting date.**

58. The estimate takes account of the risks and uncertainties that surround the events causing the liability to be recognized. Where the time value of money is material, the liability will be measured at the present value of the amount expected to be required to settle the obligation. This requirement is in accordance with the principles established in IPSAS 19.

Taxes

59. **An entity shall recognize an asset in respect of taxes when the taxable event occurs and the asset recognition criteria are met.**

60. Resources arising from taxes satisfy the definition of an asset when the entity controls the resources as a result of a past event (the taxable event) and expects to receive future economic benefits or service potential from those resources. Resources arising from taxes satisfy the criteria for recognition as

an asset when it is probable that the inflow of resources will occur and their fair value can be reliably measured. The degree of probability attached to the inflow of resources is determined on the basis of evidence available at the time of initial recognition, which includes, but is not limited to, disclosure of the taxable event by the taxpayer.

61. Taxation revenue arises only for the government that imposes the tax, and not for other entities. For example, where the national government imposes a tax that is collected by its taxation agency, assets and revenue accrue to the government, not the taxation agency. Further, where a national government imposes a sales tax, the entire proceeds of which it passes to state governments, based on a continuing appropriation, the national government recognizes assets and revenue for the tax, and a decrease in assets and an expense for the transfer to state governments. The state governments will recognize assets and revenue for the transfer. Where a single entity collects taxes on behalf of several other entities, it is acting as an agent for all of them. For example, where a state taxation agency collects income tax for the state government and several city governments, it does not recognize revenue in respect of the taxes collected – rather, the individual governments that impose the taxes recognize assets and revenue in respect of the taxes.

62. Taxes do not satisfy the definition of contributions from owners, because the payment of taxes does not give the taxpayers a right to receive distributions of future economic benefits or service potential by the entity during its life or distribution of any excess of assets over liabilities in the event of the government being wound up. Nor does the payment of taxes provide taxpayers with an ownership right in the government that can be sold, exchanged, transferred or redeemed.

63. Taxes satisfy the definition of non-exchange transaction because the taxpayer transfers resources to the government, without receiving approximately equal value directly in exchange. Whilst the taxpayer may benefit from a range of social policies established by the government, these are not provided directly in exchange as consideration for the payment of taxes.

64. As noted in paragraph 52, some taxes are levied for specific purposes. If the government is required to recognize a liability in respect of any conditions relating to assets recognized as a consequence of specific purpose tax levies, it does not recognize revenue until the condition is satisfied and the liability is reduced. However, in most cases, taxes levied for specific purposes are not expected to give rise to a liability because the specific purposes amount to restrictions not conditions.

The Taxable Event

65. Similar types of taxes are levied in many jurisdictions. The reporting entity analyzes the taxation law in its own jurisdiction to determine what the taxable

event is for the various taxes levied. Unless otherwise specified in laws or regulations, it is likely that the taxable event for:

(a) Income tax is the earning of assessable income during the taxation period by the taxpayer;

(b) Value added tax is the undertaking of taxable activity during the taxation period by the taxpayer;

(c) Goods and services tax is the purchase or sale of taxable goods and services during the taxation period;

(d) Customs duty is the movement of dutiable goods or services across the customs boundary;

(e) Death duty is the death of a person owning taxable property; and

(f) Property tax is the passing of the date on which the tax is levied, or the period for which the tax is levied, if the tax is levied on a periodic basis.

Advance Receipts of Taxes

66. Consistent with the definitions of assets, liabilities and the requirements of paragraph 59, resources for taxes received prior to the occurrence of the taxable event are recognized as an asset and a liability (advance receipts) because the event that gives rise to the entity's entitlement to the taxes has not occurred and the criteria for recognition of taxation revenue have not been satisfied (see paragraph 59), notwithstanding that the entity has already received an inflow of resources. Advance receipts in respect of taxes are not fundamentally different from other advance receipts, so a liability is recognized until the taxable event occurs. When the taxable event occurs, the liability is discharged and revenue is recognized.

Measurement of Assets Arising from Taxation Transactions

67. Paragraph 42 requires that assets arising from taxation transactions be measured at their fair value as at the date of acquisition. Assets arising from taxation transactions are measured at the best estimate of the inflow of resources to the entity. Reporting entities will develop accounting policies for the measurement of assets arising from taxation transactions that conform with the requirements of paragraph 42. The accounting policies for estimating these assets will take account of both the probability that the resources arising from taxation transactions will flow to the government, and the fair value of the resultant assets.

68. Where there is a separation between the timing of the taxable event and collection of taxes, public sector entities may reliably measure assets arising from taxation transactions by using, for example, statistical models based on the history of collecting the particular tax in prior periods. These models will

include consideration of the timing of cash receipts from taxpayers, declarations made by taxpayers and the relationship of taxation receivable to other events in the economy. Measurement models will also take account of other factors such as:

(a) The tax law allowing taxpayers a longer period to file returns than the government is permitted for publishing general purpose financial statements;

(b) Taxpayers failing to file returns on a timely basis;

(c) Valuing nonmonetary assets for tax assessment purposes;

(d) Complexities in tax law requiring extended periods for assessing taxes due from certain taxpayers;

(e) The potential that the financial and political costs of rigorously enforcing the tax laws and collecting all the taxes legally due to the government may outweigh the benefits received;

(f) The tax law permitting taxpayers to defer payment of some taxes; and

(g) A variety of circumstances particular to individual taxes and jurisdictions.

69. Measuring assets and revenue arising from taxation transactions using statistical models may result in the actual amount of assets and revenue recognized being different from the amounts determined in subsequent reporting periods as being due from taxpayers in respect of the current reporting period. Revisions to estimates are made in accordance with IPSAS 3.

70. In some cases the assets arising from taxation transactions and the related revenue cannot be reliably measured until some time after the taxable event occurs. This may occur if a tax base is volatile and reliable estimation is not possible. In many cases, the assets and revenue may be recognized in the period subsequent to the occurrence of the taxable event. However, there are exceptional circumstances when several reporting periods will pass before a taxable event results in an inflow of resources embodying future economic benefits or service potential that meets the definition of an asset and satisfies the criteria for recognition as an asset. For example, it may take several years to determine and reliably measure the amount of death duty due in respect of a large deceased estate because it includes a number of valuable antiques and artworks, which require specialist valuations. Consequently the recognition criteria may not be satisfied until payment is received or receivable.

Expenses Paid Through the Tax System and Tax Expenditures

71. **Taxation revenue shall be determined at a gross amount. It shall not be reduced for expenses paid through the tax system.**

72. In some jurisdictions, the government uses the tax system as a convenient method of paying to taxpayers benefits, which would otherwise be paid using another payment method, such as writing a check, directly depositing the amount in a taxpayer's bank account, or settling another account on behalf of the taxpayer. For example, a government may pay part of residents' health insurance premiums, to encourage the uptake of such insurance, either by reducing the individual's tax liability, making a payment by check or by paying an amount directly to the insurance company. In these cases, the amount is payable irrespective of whether the individual pays taxes. Consequently this amount is an expense of the government and should be recognized separately in the statement of financial performance. Tax revenue should be increased for the amount of any of these expenses paid through the tax system.

73. **Taxation revenue shall not be grossed up for the amount of tax expenditures.**

74. In most jurisdictions, governments use the tax system to encourage certain financial behavior and discourage other behavior. For example, in some jurisdictions, home owners are permitted to deduct mortgage interest and property taxes from their gross income when calculating tax assessable income. These types of concessions are available only to taxpayers. If an entity (including a natural person) does not pay tax, it cannot access the concession. These types of concessions are called tax expenditures. Tax expenditures are foregone revenue, not expenses, and do not give rise to inflows or outflows of resources – that is, they do not give rise to assets, liabilities, revenue or expenses of the taxing government.

75. The key distinction between expenses paid through the tax system and tax expenditures is that for expenses paid through the tax system, the amount is available to recipients irrespective of whether they pay taxes, or use a particular mechanism to pay their taxes. IPSAS 1 prohibits the offsetting of items of revenue and expense unless permitted by another Standard. The offsetting of tax revenue and expenses paid through the tax system is not permitted.

Transfers

76. **Subject to paragraph 98, an entity shall recognize an asset in respect of transfers when the transferred resources meet the definition of an asset and satisfy the criteria for recognition as an asset.**

77. Transfers include grants, debt forgiveness, fines, bequests, gifts, donations and goods and services in-kind. All these items have the common attribute that they transfer resources from one entity to another without providing approximately equal value in exchange and are not taxes as defined in this Standard.

78. Transfers satisfy the definition of an asset when the entity controls the resources as a result of a past event (the transfer) and expects to receive future

economic benefits or service potential from those resources. Transfers satisfy the criteria for recognition as an asset when it is probable that the inflow of resources will occur and their fair value can be reliably measured. In certain circumstances, such as when a creditor forgives a liability, a decrease in the carrying amount of a previously recognized liability may arise. In these cases, instead of recognizing an asset as a result of the transfer, the entity decreases the carrying amount of the liability.

79. An entity obtains control of transferred resources either when the resources have been transferred to the entity, or the entity has an enforceable claim against the transferor. Many arrangements to transfer resources become binding on all parties before the transfer of resources takes place. However, sometimes one entity promises to transfer resources, but fails to do so. Consequently only when a claim is enforceable, and the entity assesses that it is probable that the inflow of resources will occur will assets, liabilities and or revenue be recognized. Until that time, the entity cannot exclude or regulate the access of third parties to the benefits of the resources proposed for transfer.

80. Transfers of resources that satisfy the definition of contributions from owners will not give rise to revenue. Agreements that specify that the entity providing resources is entitled to distributions of future economic benefits or service potential during the recipient entity's life, or distribution of any excess of assets over liabilities in the event that the recipient entity is wound up, or that specify that the entity providing resources acquires a financial interest in the recipient entity that can be sold, exchanged, transferred or redeemed, are, in substance, agreements to make a contribution from owners.

81. Transfers satisfy the definition of non-exchange transactions because the transferor provides resources to the recipient entity without the recipient entity providing approximately equal value directly in exchange. If an agreement stipulates that the recipient entity is to provide approximately equal value in exchange, the agreement is not a transfer agreement, but a contract for an exchange transaction that should be accounted for under IPSAS 9.

82. An entity analyzes all stipulations contained in transfer agreements to determine if it incurs a liability when it accepts transferred resources.

Measurement of Transferred Assets

83. As required by paragraph 42, transferred assets are measured at their fair value as at the date of acquisition. Entities develop accounting policies for the recognition and measurement of assets that are consistent with IPSASs. As noted previously, inventories, property, plant, equipment or investment property acquired through non-exchange transactions are to be initially measured at their fair value as at the date of acquisition in accordance with the requirements of IPSASs 12, 16 and 17. Financial instruments, including cash and transfers receivable that satisfy the definition of a financial instrument, and other assets

will also be measured at fair value as at the date of acquisition in accordance with paragraph 42 and the appropriate accounting policy.

Debt Forgiveness and Assumption of Liabilities

84. Lenders will sometimes waive their right to collect a debt owed by a public sector entity, effectively canceling the debt. For example, a national government may cancel a loan owed by a local government. In such circumstances, the local government recognizes an increase in net assets because a liability it previously recognized is extinguished.

85. Entities recognize revenue in respect of debt forgiveness when the former debt no longer meets the definition of a liability or satisfies the criteria for recognition as a liability, provided that the debt forgiveness does not satisfy the definition of a contribution from owners.

86. Where a controlling entity forgives debt owed by a wholly owned controlled entity, or assumes its liabilities, the transaction may be a contribution from owners, as described in paragraphs 37–38.

87. Revenue arising from debt forgiveness is measured at the fair value of the debt forgiven. This will normally be the carrying amount of the debt forgiven.

Fines

88. Fines are economic benefits or service potential received or receivable by a public sector entity, from an individual or other entity, as determined by a court or other law enforcement body, as a consequence of the individual or other entity breaching the requirements of laws or regulations. In some jurisdictions law enforcement officials are able to impose fines on individuals considered to have breached the law. In these cases, the individual will normally have the choice of paying the fine, or going to court to defend the matter. Where a defendant reaches an agreement with a prosecutor that includes the payment of a penalty instead of being tried in court, the payment is recognized as a fine.

89. Fines normally require an entity to transfer a fixed amount of cash to the government and do not impose on the government any obligations which may be recognized as a liability. As such, fines are recognized as revenue when the receivable meets the definition of an asset and satisfies the criteria for recognition as an asset set out in paragraph 31. As noted in paragraph 12, where an entity collects fines in the capacity of an agent, the fine will not be revenue of the collecting entity. Assets arising from fines are measured at the best estimate of the inflow of resources to the entity.

Bequests

90. A bequest is a transfer made according to the provisions of a deceased person’s will. The past event giving rise to the control of resources

embodying future economic benefits or service potential for a bequest occurs when the entity has an enforceable claim, for example on the death of the testator, or the granting of probate, depending on the laws of the jurisdiction.

91. Bequests which satisfy the definition of an asset are recognized as assets and revenue when it is probable that the future economic benefits or service potential will flow to the entity and the fair value of the assets can be measured reliably. Determining the probability of an inflow of future economic benefits or service potential may be problematic if a period of time elapses between the death of the testator and the entity receiving any assets. The entity will need to determine if the deceased person's estate is sufficient to meet all claims on it, and satisfy all bequests. If the will is disputed, this will also affect the probability of assets flowing to the entity.

92. The fair value of bequeathed assets is determined in the same manner as for gifts and donations, as is described in paragraph 97. In jurisdictions where deceased estates are subject to taxation, the tax authority may already have determined the fair value of the asset bequeathed to the entity, and this amount may be available to the entity. Bequests are measured at the fair value of the resources received or receivable.

Gifts and Donations, including Goods In-kind

93. Gifts and donations are voluntary transfers of assets including cash or other monetary assets, goods in-kind and services in-kind that one entity makes to another, normally free from stipulations. The transferor may be an entity or an individual. For gifts and donations of cash or other monetary assets and goods in-kind, the past event giving rise to the control of resources embodying future economic benefits or service potential is normally the receipt of the gift or donation. Recognition of gifts or donations of services in-kind are addressed in paragraphs 98-103 below.

94. Goods in-kind are tangible assets transferred to an entity in a non-exchange transaction, without charge, but may be subject to stipulations. External assistance provided by multilateral or bilateral development organizations often includes a component of goods in-kind.

95. Gifts and donations (other than services in-kind) are recognized as assets and revenue when it is probable that the future economic benefits or service potential will flow to the entity and the fair value of the assets can be measured reliably. With gifts and donations, the making of the gift or donation and the transfer of legal title are often simultaneous, in such circumstances, there is no doubt as to the future economic benefits flowing to the entity.

96. Goods in-kind are recognized as assets when the goods are received, or there is a binding arrangement to receive the goods. If goods in-kind are received without conditions attached, revenue is recognized immediately. If conditions

are attached, a liability is recognized, which is reduced and revenue recognized as the conditions are satisfied.

97. On initial recognition, gifts and donations including goods in-kind are measured at their fair value as at the date of acquisition, which may be ascertained by reference to an active market, or by appraisal. An appraisal of the value of an asset is normally undertaken by a member of the valuation profession who holds a recognized and relevant professional qualification. For many assets, the fair value will be readily ascertainable by reference to quoted prices in an active and liquid market. For example, current market prices can usually be obtained for land, nonspecialized buildings, motor vehicles and many types of plant and equipment.

Services In-kind

98. **An entity may, but is not required to, recognize services in-kind as revenue and as an asset.**

99. Services in-kind are services provided by individuals to public sector entities in a non-exchange transaction. These services meet the definition of an asset because the entity controls a resource from which future economic benefits or service potential are expected to flow to the entity. These assets are, however, immediately consumed and a transaction of equal value is also recognized to reflect the consumption of these services in-kind. For example, a public school that receives volunteer services from teachers' aides, the fair value of which can be reliably measured, may recognize an increase in an asset and revenue, and a decrease in an asset and an expense. In many cases, the entity will recognize an expense for the consumption of services in-kind. However, services in-kind may also be utilized to construct an asset, in which case the amount recognized in respect of services in-kind is included in the cost of the asset being constructed.

100. Public sector entities may be recipients of services in-kind under voluntary or nonvoluntary schemes operated in the public interest, for example:

(a) Technical assistance from other governments or international organizations;

(b) Persons convicted of offenses may be required to perform community service for a public sector entity;

(c) Public hospitals may receive the services of volunteers;

(d) Public schools may receive voluntary services from parents as teachers' aides or as board members; and

(e) Local governments may receive the services of volunteer fire fighters.

101. Some services in-kind do not meet the definition of an asset because the entity has insufficient control over the services provided. In other circumstances, the

entity may have control over the services in-kind, but may not be able to measure them reliably, and thus they fail to satisfy the criteria for recognition as an asset. Entities may, however, be able to measure the fair value of certain services in-kind, such as professional or other services in-kind which are otherwise readily available in the national or international marketplace. When determining the fair value of the types of services in-kind described in paragraph 100, the entity may conclude that the value of the services is not material. In many instances, services in-kind are rendered by persons with little or no training and are fundamentally different from the services the entity would acquire if the services in-kind were not available.

102. Due to the many uncertainties surrounding services in-kind, including the ability to exercise control over the services, and measuring the fair value of the services, this Standard does not require the recognition of services in-kind. Paragraph 108, however, encourages the disclosure of the nature and type of services in-kind received during the reporting period. As for all disclosures, disclosures relating to services in-kind are only made if they are material. For some public sector entities, the services provided by volunteers are not material in amount, but may be material by nature.

103. In developing an accounting policy addressing a class of services in-kind, various factors would be considered, including the effects of those services in-kind on the financial position, performance and cash flows of the entity. The extent to which an entity is dependent on a class of services in-kind to meet its objectives, may influence the accounting policy an entity develops regarding the recognition of assets. For example, an entity that is dependant on a class of services in-kind to meet its objectives, may be more likely to recognize those services in-kind that meet the definition of an asset and satisfy the criteria for recognition. In determining whether to recognize a class of services in-kind, the practices of similar entities operating in a similar environment are also considered.

Pledges

104. Pledges are unenforceable undertakings to transfer assets to the recipient entity. Pledges do not meet the definition of an asset because the recipient entity is unable to control the access of the transferor to the future economic benefits or service potential embodied in the item pledged. Entities do not recognize pledged items as assets or revenue. If the pledged item is subsequently transferred to the recipient entity, it is recognized as a gift or donation, in accordance with paragraphs 93 – 97 above. Pledges may warrant disclosure as contingent assets under the requirements of IPSAS 19.

Advance Receipts of Transfers

105. Where an entity receives resources before a transfer arrangement becomes binding, the resources are recognized as an asset when they meet the

definition of an asset and satisfy the criteria for recognition as an asset. The entity will also recognize an advance receipt liability if the transfer arrangement is not yet binding. Advance receipts in respect of transfers are not fundamentally different from other advance receipts, so a liability is recognized until the event which makes the transfer arrangement binding occurs and all other conditions under the agreement are fulfilled. When that event occurs and all other conditions under the agreement are fulfilled, the liability is discharged and revenue is recognized.

Disclosures

106. **An entity shall disclose either on the face of, or in the notes to, the general purpose financial statements:**

(a) **The amount of revenue from non-exchange transactions recognized during the period by major classes showing separately:**

(i) **Taxes, showing separately major classes of taxes; and**

(ii) **Transfers, showing separately major classes of transfer revenue.**

(b) **The amount of receivables recognized in respect of non-exchange revenue;**

(c) **The amount of liabilities recognized in respect of transferred assets subject to conditions;**

(d) **The amount of assets recognized that are subject to restrictions and the nature of those restrictions;**

(e) **The existence and amounts of any advance receipts in respect of non-exchange transactions; and**

(f) **The amount of any liabilities forgiven.**

107. **An entity shall disclose in the notes to the general purpose financial statements:**

(a) **The accounting policies adopted for the recognition of revenue from non-exchange transactions;**

(b) **For major classes of revenue from non-exchange transactions, the basis on which the fair value of inflowing resources was measured;**

(c) **For major classes of taxation revenue which the entity cannot measure reliably during the period in which the taxable event occurs, information about the nature of the tax; and**

(d) **The nature and type of major classes of bequests, gifts, donations showing separately major classes of goods in-kind received.**

108. Entities are encouraged to disclose the nature and type of major classes of services in-kind received, including those not recognized. The extent to which an entity is dependent on a class of services in-kind will determine the disclosures it makes in respect of that class.

109. The disclosures required by paragraphs 106 and 107 assist the reporting entity to satisfy the objectives of financial reporting, as set out in IPSAS 1, which is to provide information useful for decision making and to demonstrate the accountability of the entity for the resources entrusted to it.

110. Disclosure of the major classes of revenue assists users to make informed judgments about the entity's exposure to particular revenue streams.

111. Conditions and restrictions impose limits on the use of assets, which impacts the operations of the entity. Disclosure of the amount of liabilities recognized in respect of conditions and the amount of assets subject to restrictions assists users in making judgments about the ability of the entity to use its assets at its own discretion. Entities are encouraged to disaggregate by class the information required to be disclosed by paragraph 106(c).

112. Paragraph 106(e) requires entities to disclose the existence of advance receipts in respect of non-exchange transactions. These liabilities carry the risk that the entity will have to make a sacrifice of future economic benefits or service potential if the taxable event does not occur, or a transfer arrangement does not become binding. Disclosure of these advance receipts assists users to make judgements about the entity's future revenue and net asset position.

113. As noted in paragraph 68, in many cases an entity will be able to reliably measure assets and revenue arising from taxation transactions, using, for example, statistical models. However, there may be exceptional circumstances where an entity is unable to reliably measure the assets and revenue arising until one or more reporting periods has elapsed since the taxable event occurred. In these cases, the entity makes disclosures about the nature of major classes of taxation that cannot be reliably measured, and therefore recognized, during the reporting period in which the taxable event occurs. These disclosures assist users to make informed judgements about the entity's future revenue and net asset position.

114. Paragraph 107(d) requires entities to make disclosures about the nature and type of major classes of gifts, donations and bequests it has received. These inflows of resources are received at the discretion of the transferor, which exposes the entity to the risk that in future periods, such sources of resources may change significantly. Such disclosures assist users to make informed judgements about the entity's future revenue and net asset position.

115. Where services in-kind meet the definition of an asset and satisfy the criteria for recognition as an asset, entities may elect to recognize these services in-kind and measure them at their fair value. Paragraph 108 encourages an entity to make

disclosures about the nature and type of all services in-kind received, whether they are recognized or not. Such disclosures may assist users to make informed judgments about the contribution made by such services to the achievement of the entity's objectives during the reporting period, and the entity's dependence on such services for the achievement of its objectives in the future.

Transitional Provisions

116. **Entities are not required to change their accounting policies in respect of the recognition and measurement of taxation revenue for reporting periods beginning on a date within five years following the date of first adoption of this Standard.**

117. **Entities are not required to change their accounting policies in respect of the recognition and measurement of revenue from non-exchange transactions, other than taxation revenue, for reporting periods beginning on a date within three years following the date of first adoption of this Standard.**

118. **Changes in accounting policies in respect of the recognition and measurement of revenue from non-exchange transactions made before the expiration of the five year period permitted in paragraph 116, or the three year period permitted in paragraph 117, shall only be made to better conform to the accounting policies of this Standard. Entities may change their accounting policies in respect of revenue from non-exchange transactions on a class by class basis.**

119. **When an entity takes advantage of the transitional provisions in paragraph 116 or 117, that fact shall be disclosed. The entity shall also disclose which classes of revenue from non-exchange transactions are recognized in accordance with this Standard, which have been recognized under an accounting policy that is not consistent with the requirements of this Standard, and the entity's progress towards implementation of accounting policies that are consistent with this Standard. The entity shall disclose its plan for implementing accounting policies that are consistent with this Standard.**

120. **When an entity takes advantage of the transitional provisions for a second or subsequent reporting period, details of the classes of revenue from non-exchange transactions previously recognized on another basis, but which are now recognized in accordance with this Standard, shall be disclosed.**

121. The transitional provisions are intended to allow entities a period to develop reliable models for measuring revenue from non-exchange transactions during the transitional period. Entities may adopt accounting policies for the recognition of revenue from non-exchange transactions that do not comply with the provisions of this Standard. The transitional provisions allow entities to apply this Standard incrementally to different classes of revenue from non-

exchange transactions. For example, entities may be able to recognize and measure property taxes and some classes of transfers in accordance with this Standard from the date of application, but may require up to five years to fully develop a reliable model for measuring income tax revenue.

122. When an entity takes advantage of the transitional provisions in this Standard, its accounting policies for each class of revenue from non-exchange transactions may only be changed to better conform to this Standard. An entity may retain its existing accounting policies until it decides to fully apply the provisions of this Standard or until the transitional provisions expire, whichever is earlier, or it may change them to apply the requirements of this Standard progressively. An entity may, for example, change from a policy of recognition on a cash basis, to a modified cash or modified accrual basis before it fully applies this Standard.

123. The disclosure requirements of paragraph 119 assist users to track the progress of the entity in conforming its accounting policies to the requirements of this IPSAS during the reporting periods in which the transitional provisions apply. This disclosure facilitates the objective of full accountability and transparency.

Effective Date

124. **This IPSAS becomes effective for annual financial statements covering periods beginning on or after June 30, 2008. Earlier application is encouraged. If an entity applies this Standard for periods beginning before June 30, 2008, it shall disclose that fact.**

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

Implementation Guidance

Measurement, Recognition and Disclosure of Revenue from Non-Exchange Transactions—Examples

This guidance accompanies, but is not part of IPSAS 23.

Example 1: Income Tax (Paragraph 65)

IG1. A national government (reporting entity) imposes a 25 percent tax on personal income earned within the country. Employers are required to withhold taxes from payroll and remit withholdings on a monthly basis. Individuals with significant nonsalary (for example, investment) income are required to make estimated tax payments on a quarterly basis. In addition, individuals must file a tax return with the taxation department by April 15 of the year following the tax year (calendar year) and must pay the remaining tax owed (or claim a refund) at that time. The government's reporting period ends on June 30.

IG2. The government controls a resource – income tax receivable – when the taxable event occurs, which is the earning of assessable income by taxpayers. At the end of the reporting period, the government recognizes assets and revenue in respect of personal income tax on the income earned during the reporting period to the extent that it can reliably measure it. Assets and revenue will also be recognized in respect of income taxes on income earned in prior periods, but which did not meet the definition of, or satisfy the criteria for recognition as, an asset until the current reporting period.

Example 2: Measurement of Taxation Revenue (Paragraphs 67 - 70)

IG3. A national government (reporting entity) levies income tax on the personal income of all persons earning income within its jurisdiction. The tax was first levied some seventy years before the current reporting period, and taxation statistics are available for the entire seventy year period. The tax year and the reporting period are January 1 to December 31. Taxpayers have until April 30 each year to file their tax return, and until June 30 to pay any outstanding taxes. The government is required by legislation to present audited consolidated general purpose financial statements to the legislature no later than March 31.

IG4. Income tax revenue should be recognized in the reporting period in which the taxable event occurred, that is, the earning of taxable income. As the tax administration system does not enable the government to directly measure income tax receivable until after its general purpose financial statements are issued, the government develops a model to indirectly measure income taxation revenue receivable. The government uses the income tax collection history it has in the taxation statistics, which it compares to other observable phenomena to develop a reliable model. Other phenomena can include other economic statistics, such as gross domestic product, financial phenomena such as income tax installments deducted by employers, sales tax collections (if it levies such a tax) and banking statistics collected by the central bank. This government may enlist the assistance of econometricians in developing the model, and the external auditor tests the validity of the model in accordance with international and national auditing standards.

IG5. The model enables the reporting entity to reliably measure the assets and revenue accruing to it during the reporting period, which are then recognized and disclosed in the general purpose financial statements. The notes to the general purpose financial statements disclose the accounting policies, including the basis of measurement of income tax revenue. In these circumstances estimates of tax revenue for one reporting period may be revised in a subsequent period. Changes in estimates are recognized prospectively in accordance with IPSAS 3.

Example 3: Value Added Tax (Paragraph 65)[1]

IG6. A national government (reporting entity) imposes a value added tax (VAT) on all businesses. The tax is 15 percent of the value added and is collected by merchants from customers (taxpayers) at the time of sale. Large and medium sized businesses are required to submit VAT returns electronically to the tax department on a weekly basis; however, small businesses are permitted to submit VAT returns manually on a quarterly basis.

IG7. The government controls a resource – VAT receivable – when the taxable event occurs, which is the undertaking of taxable activity, that is, the sale of value added goods or services, during the reporting period. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which the taxable activity takes place, or later, as soon as it can reliably measure the tax receivable. In many circumstances, the taxation return period will not coincide with the reporting period. In these circumstances estimates of tax revenue for the reporting period may be revised in a subsequent period. Changes in estimates are recognized prospectively in accordance with IPSAS 3.

Example 4: Goods and Services Tax (Paragraph 65)

IG8. A national government (reporting entity) imposes a goods and services tax (GST) on sales of goods and services. The tax is 10 percent of the value of goods and services sold. Most sellers of goods and services are required to electronically submit GST returns to the tax department on a weekly basis. However, small businesses are permitted to manually submit GST returns on a quarterly basis.

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1 Some jurisdictions use the terms Value Added Tax (VAT) and Goods and Services Tax (GST) interchangeably.

IG9. The government controls a resource – GST receivable – when the taxable event occurs, which is the sale of taxable goods and services during the reporting period. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which the sales and purchases take place or, if the tax receivable cannot be reliably measured as at the end of the reporting period, later, as soon as it can reliably measure the tax receivable.

Example 5: Customs Duty (Paragraph 65)

IG10. A national government (reporting entity) imposes customs duty on all imports of goods. The duties vary depending on the type of goods imported and are set at levels to ensure that domestically produced goods are cheaper in the retail market. Imported goods are held in bonded warehouses until the importer pays the duty. Importers are required to make import declarations to the customs department and pay the duty immediately. Most importers submit these declarations electronically before the goods arrive, and make electronic funds transfers to the customs department when the goods are unloaded from ships or aircraft, or as trains or trucks pass the customs boundary.

IG11. The government controls a resource – duty receivable – when the taxable event occurs, which is the movement of goods across the customs boundary. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which the goods move across the boundary, or later, as soon as it can reliably measure the duty receivable.

Example 6: Death Duties (Paragraph 65)

IG12. A national government (reporting entity) imposes death duties of 40 percent on all estates valued at more than 500,000 currency units (CU). Medical practitioners and funeral directors are required to notify the tax department of all deaths. An assessor then makes an interim valuation of the estate to determine whether duty will be payable. Executors of estates are required to file an inventory of the estate with the tax department, which values the estate and determines the duty due from the estate. Probate cannot be granted until all duty is paid. Due to complexities in testamentary law and frequent appeals of valuations, it takes on average four years to settle estates and collect the duty due.

IG13. The government controls a resource – death duties receivable – when the taxable event occurs, which is the death of a person owning taxable property. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which the person dies, or later, as soon as it can reliably measure the assets.

Example 7: Property Tax (Paragraph 65)

IG14. A local government (reporting entity) levies a tax of one percent of the assessed value of all property within its jurisdiction. The government's reporting period is July 1 to June 30. The tax is levied on July 31, with notices of assessment being sent to property owners in July, and payment due by August 31. If taxes are unpaid on that date, property owners incur penalty interest rate payments of three percent per month of the amount outstanding. The tax law permits the government to seize and sell a property to collect outstanding taxes.

IG15. The government controls a resource – property taxes receivable – when the taxable event occurs, which is the passing of the date on which the taxes are levied – July 31. The government recognizes assets and revenue in the general purpose financial statements of the reporting period in which that date occurs.

Example 8: Advance Receipts of Income Tax (Paragraph 66)

IG16. Government A (reporting entity) levies income tax on all residents within its jurisdiction. The tax period and the reporting period are January 1 to December 31. Selfemployed taxpayers are required to pay an estimate of their income tax for the year by December 24 of the year immediately preceding the commencement of the tax year. The tax law sets the estimate as the amount due for the most recently completed assessment, plus one tenth, unless the taxpayer provides an explanation prior to December 24 of a lower amount (penalties apply if the taxpayer's assessment proves to be materially lower than the final amount owed). After the end of the tax period, self-employed taxpayers file their tax returns and receive refunds, or pay additional tax to the government.

IG17. The resources received from self-employed taxpayers by December 24 are advance receipts against taxes due for the following year. The taxable event is the earning of income during the taxation period, which has not commenced. The reporting entity recognizes an increase in an asset (cash in bank) and an increase in a liability (advance receipts).

Example 9: Grant to Another Level of Government for General Purposes (Paragraphs 14-16, 76)

IG18. The national government (transferor) makes a grant of CU10 million to a local government in a socioeconomically deprived area. The local government (reporting entity) is required under its constitution to undertake various social programs; however it has insufficient resources to undertake all of these programs without assistance. There are no stipulations attached to the grant. All local governments are required to prepare and present audited general purpose financial statements.

IG19. There are no stipulations attached to these grants, and no performance obligation, so the transfers are recognized as assets and revenue in the general purpose financial statements of the reporting period in which the they are received or receivable by the local government.

Example 10: Transfer with Stipulations that do not Satisfy the Definition of a Condition (Paragraphs 20–25)

IG20. A national government makes a cash transfer of CU50 million to a state government social housing entity specifying that it:

(a) Increases the stock of social housing by an additional 1,000 units over and above any other planned increases; or

(b) Uses the cash transfer in other ways to support its social housing objectives.

If neither of these stipulations is satisfied the recipient entity must return the cash to the national government.

IG21. The state government social housing entity recognizes an increase in an asset (cash) and revenue in the amount of CU50 million. The stipulations in the transfer agreement are stated so broadly as to not impose on the recipient a performance obligation – the performance obligation is imposed by the operating mandate of the entity, not by the terms of the transfer.

Example 11: Transfer to a Public Sector University with Restrictions (Paragraphs 19 and 76)

IG22. The national government (transferor) transfers 200 hectares of land in a major city to a university (reporting entity) for the establishment of a university campus. The transfer agreement specifies that the land is to be used for a campus, but does not specify that the land is to be returned if not used for a campus.

IG23. The university recognizes the land as an asset in the statement of financial position of the reporting period in which it obtains control of that land. The land should be recognized at its fair value in accordance with IPSAS 17. The restriction does not meet the definition of a liability or satisfy the criteria for recognition as a liability. Therefore, the university recognizes revenue in respect of the land in the statement of financial performance of the reporting period in which the land is recognized as an asset.

Example 12: Grant to Another Level of Government with Conditions (see paragraphs 17–18)

IG24. The national government (transferor) grants CU10 million to a provincial government (reporting entity) to be used to improve and maintain mass transit systems. Specifically, the money is required to be used as follows: 40 percent for existing railroad and tramway system modernization, 40 percent for new railroad or tramway systems and 20 percent for rolling stock purchases and improvements. Under the terms of the grant, the money can only be used as stipulated and the provincial government is required to include a note in its audited general purpose financial statements detailing how the grant money was spent. The agreement requires the grant to be spent as specified in the current year or be returned to the national government.

IG25. The provincial government recognizes the grant money as an asset. The provincial government also recognizes a liability in respect of the condition attached to the grant. As the province satisfies the condition, that is, as it makes authorized expenditures, it reduces the liability and recognizes revenue in the statement of financial performance of the reporting period in which the liability is discharged.

Example 13: Research Grant (in Substance Exchange Transaction) (Paragraph 8)

IG26. A large corporation that makes cleaning products (transferor) gives money to a public university (reporting entity) to conduct research on the effectiveness of a certain chemical compound in quickly removing graffiti. The corporation stipulates that the research results are to be shared with it before being announced to the public and that it has the right to apply for a patent on the compound.

IG27. This is an exchange transaction. In return for the grant, the university provides research services and an intangible asset, the right (a future economic benefit) to profit from the research results. IPSAS 9 and the relevant international or national accounting standard dealing with intangible assets apply to this transaction.

Example 14: Debt Forgiveness (Paragraphs 84–87)

IG28. The national government (transferor) lent a local government (reporting entity) CU20 million to enable the local government to build a water treatment plant. After a change in policy, the national government decides to forgive the loan. There are no stipulations attached to the forgiveness of the loan. The national government writes to the local government and advises it of its decision; it also encloses the loan documentation, which has been annotated to the effect that the loan has been waived.

IG29. When it receives the letter and documentation from the national government, which communicates this decision, the local government derecognizes the liability for the loan and recognizes revenue in the statement of financial performance of the reporting period in which the liability is derecognized.

Example 15: Purchase of Property with Exchange and Non-Exchange Components (Paragraphs 8–11, 39–41)

IG30. A public school (reporting entity) purchases land with a fair value of CU100,000 for CU50,000 from a local government. The reporting entity concludes that the non-exchange transaction comprises two components, an exchange component and a non-exchange component. One component involves the purchase of a half share in the land for CU50,000, the other component is a non-exchange transaction that transfers the remaining half share of the land to the school.

IG31. In its general purpose financial statements for the reporting period in which the transaction takes place, the public school recognizes the land at CU100,000, (a cost of CU50,000 and a transfer of CU50,000) a reduction in its asset cash of CU50,000 and revenue from a non-exchange transaction of CU50,000 (the fair value of the increase in net assets recognized).

Example 16: Proposed Bequest (Paragraphs 90–92)

IG32. A 25 year old recent graduate (transferor) of a public university names the university (reporting entity) as the primary beneficiary in her will. This is communicated to the university. The graduate is unmarried and childless and has an estate currently valued at CU500,000.

IG33. The public university does not recognize any asset or revenue in its general purpose financial statements for the period in which the will is made. The past event for a bequest is the death of the testator (transferor), which has not occurred.

Example 17: Pledge – Television Appeal for Public Hospital (Paragraph 104)

IG34. On the evening of June 30, 20X5 a local television station conducts a fundraising appeal for a public hospital (reporting entity). The annual reporting date of the public hospital is June 30. Television viewers telephone or e-mail promising to send donations of specified amounts of money. At the conclusion of the appeal, CU2 million has been pledged. The pledged donations are not binding on those making the pledge. Experience with previous appeals indicates approximately 75 percent of pledged donations will be made.

IG35. The public hospital does not recognize any amount in its general purpose financial statements in respect of the pledges. The entity does not control the resources related to the pledge because it cannot exclude or regulate the access of the prospective transferors to the economic benefits or service potential of the pledged resources, therefore, it cannot recognize the asset or the related revenue until the donation is binding on the donor.

Example 18: Fine (Paragraph 88–89)

IG36. A major corporation is found guilty of polluting a river. As a penalty it is required to clean up the pollution and to pay a fine of CU50 million. The company is in sound financial condition and is capable of paying the fine. The company has announced that it will not appeal the case.

IG37. The government (reporting entity) recognizes a receivable and revenue of CU50 million in the general purpose financial statements of the reporting period in which the fine is imposed.

Example 19: External Assistance Recognized (Paragraph 76–82)

IG38. National Government A (reporting entity) enters into an external assistance agreement with National Government B, which provides National Government A with development assistance grants to support National Government A's health objectives over a two year period. The external assistance agreement is binding on both parties. The agreement specifies the details of the development assistance receivable by National Government A. Government A measures the fair value of the development assistance at CU5 million.

IG39. When the external assistance agreement becomes binding, National Government A recognizes an asset (a receivable) for the amount of CU5 million, and revenue in the same amount. The resources meet the definition of an asset and satisfy the recognition criteria when the agreement becomes binding. There are no conditions attached to this agreement that require the entity to recognize a liability.

Example 20: Revenue of Aid Agency (Paragraphs 76, 93–97)

IG40. Green-Aid Agency relies on funding from a group of governments. The governments have signed a formal agreement, which determines the percentage of Green-Aid Agency's approved budget that each government will fund. Green-Aid Agency can only use the funds to meet the expenses of the budget year for which the funds are provided. Green-Aid Agency's financial year begins on January 1. Green-Aid Agency's budget is approved in the preceding October and the invoices are mailed out to the individual governments ten days after the budget is approved. Some governments pay before the start of the financial year and some during the financial year. However, based on past experience, some governments are very unlikely to pay what they owe, either during the financial year or at any future time.

IG41. For the budget year 20X8, the profile of amounts and timing of payments was as follows:

	(CU Million)
Budget approved October 24, 20X7	55
Amount invoiced November 4, 20X7	55
Transfers received as at December 31, 20X7	15
Transfers received during 20X8	38
Amount not received by December 31, 20X8 and unlikely to be received	2

IG42. In 20X7, Green-Aid Agency recognizes an asset of CU15 Million for the amount of transfers received before the start of 20X8, because it has control

over an asset when the transfer is received and deposited in its bank account. An equivalent CU15 Million liability, revenue received in advance, is recognized.

IG43. In 20X8, Green Aid Agency recognizes CU53 million of revenue from transfers. In the notes to its general purpose financial statements, it discloses that CU55 Million was invoiced and an allowance for doubtful debts of CU2 Million was established.

Example 21: Goods In-kind Recognized as Revenue (Paragraphs 42, 93–97)

IG44. Transferor Government A has an arrangement with the public sector reporting entity, Aid Agency Inc., whereby Government A provides rice to meet its promised financial commitments to Aid Agency Inc. Based on the variability in Government A's past performance in meeting its commitments, Aid Agency Inc. has adopted an accounting policy of not recognizing the asset and revenue until receipt of the promised rice. Government A promises to provide Aid Agency Inc. with CU300,000 during 20X5. Government A subsequently transfers 1,000 metric tons of rice to Aid Agency Inc. on January 12, 20X5. The transfer of the rice takes place in one of the ports of the transferor nation. According to the details of the funding agreement between Aid Agency Inc. and Government A, the rice is valued at the previously agreed amount of CU300 per ton, with the result that the transfer of 1,000 metric tons of rice fully discharges Government A's financial commitment of CU300,000. During February and March 20X5, Aid Agency Inc. provides the rice to a network of local distribution agencies in Nations B and C in order to meet the needs of starving people.

IG45. On January 12, 20X5 the market price of 1,000 metric tons of rice was: CU280,000 in Government A's nation; CU250,000 in the international commodities market; CU340,000 in recipient Nation B and CU400,000 in recipient Nation C.

IG46. The fair value of the rice at the time of the donation must be determined to measure the revenue that Aid Agency Inc. recognizes. The financial agreement between the donor and the aid agency, which allows the rice to be valued at CU300 per metric ton, depends on a private agreement between the two parties and does not necessarily reflect the fair value of the rice. Both Aid Agency Inc. and Donor Government A have the option of purchasing the rice on the world market at the lower price of CU250,000. The market prices for individual countries appear open to fluctuation – either as a result of trade barriers or, in the case of recipient countries, temporary distortions due to severe food shortages and may not reflect a transfer between a knowledgeable willing buyer and a knowledgeable willing seller in an orderly market. Therefore, the world market price of CU250,000 is the most reliable and relevant reflection of fair value for the donated rice. Aid Agency Inc. recognizes an increase in an asset (rice inventory) and revenue of CU250,000 in its general purpose financial statements for the year in which the transfer is received.

Example 22: Disclosure of Services In-kind not Recognized (Paragraphs 98–102, 108)

IG47. A public hospital's (reporting entity) accounting policies are to recognize voluntary services received as assets and revenue when they meet the definition of an asset and satisfy the criteria for recognition as assets. The hospital enlists the services of volunteers as part of an organized program. The principal aim of the program is to expose volunteers to the hospital environment and to promote nursing as a career. Volunteers must be at least sixteen years of age and are initially required to make a six month commitment to work one four hour morning or afternoon shift per week. The first shift for each volunteer consists of a hospital orientation training session. Many local high schools permit students to undertake this work as part of their education program. Volunteers work under the direction of a registered nurse and perform nonnursing duties such as visiting patients and reading to patients. The public hospital does not pay the volunteers nor would it engage employees to perform volunteers' work if volunteers were not available.

IG48. The hospital analyzes the agreements it has with the volunteers and concludes that, at least for a new volunteer's first six months, it has sufficient control over the services to be provided by the volunteer to satisfy the definition of control of an asset. The hospital also concludes that it receives service potential from the volunteers, satisfying the definition of an asset. However, it concludes that it cannot reliably measure the fair value of the services provided by the volunteers, because there are no equivalent paid positions either in the hospital or in other health or community care facilities in the region. The hospital does not recognize the services in-kind provided by the volunteers. The hospital discloses the number of hours of service provided by volunteers during the reporting period and a description of the services provided.

Example 23: Contribution from Owners (Paragraphs 37–38)

IG49. In 20X0 the neighboring cities of Altonae, Berolini and Cadomi form the Tri-Cities Electricity Generating Service (TCEGS) (reporting entity). The charter establishing TCEGS is binding on the city governments and provides for equal ownership, which can only be changed by agreement. The cities contribute CU25 million each to establish TCEGS. These contributions satisfy the definition of a contribution from owners, which the entity recognizes as such. The charter also provides for the cities to purchase the output of the TCEGS in proportion to their ownership. The purchase price is equal to the full costs of production. In 20X9, the city of Berolini gives approval for the construction of an aluminum smelter within the city, which will result in a doubling of the city's electricity demand. The three cities agree to amend the charter of TCEGS to permit Berolini to make a contribution from owners to enable the construction of additional generating capacity. After an independent valuation of TCEGS, the cities agree that Berolini may make a

CU50 million contribution from owners and increase its ownership share to 49.9%, with Altonae and Cadomi retaining 25.05% each.

IG50. When the amendment to the charter becomes binding TCEGS will recognize an increase in assets of CU50 million (cash or contribution from owners receivable) and a contribution from owners of CU50 million.

Example 24: Grant Agreement Term not Requiring Recognition of a Liability (Paragraphs 20–25)

IG51. National Park Department (reporting entity) of Country A receives a grant of CU500,000 from the bilateral aid agency of Country B. The grant agreement stipulates that the grant is required to be used to rehabilitate deforested areas of Country A's existing wilderness reserves, but if the money is not used for the stated purpose, it must be returned to Country B. The terms of the grant agreement are enforceable in the courts of Country A, and in international courts of justice. This is the thirteenth year that National Park Department has received a grant of this type from the same transferor. In prior years, the grant has not been used as stipulated, but has been used to acquire additional land adjacent to national parks for incorporation into the parks. National Park Department has not conducted any rehabilitation of deforested areas in the past thirteen years. Country B's bilateral aid agency is aware of the breach of the agreement term.

IG52. National Park Department analyzes the transaction and concludes that although the terms of the grant agreement are enforceable, because the bilateral aid agency has not enforced the condition in the past, and given no indication that it ever would, the terms have the form of a stipulation and condition, but not the substance. National Park Department recognizes an increase in an asset (cash in bank) and grant revenue; it does not recognize a liability.

Example 25: Disclosures Made in the Financial Statements of Government A (Paragraph 106–108)

IG53. For the year ended December 31, 20X2, Government A prepares and presents financial statements prepared in accordance with IPSASs for the first time. It makes the following disclosures in its financial statements:

Statement of Financial Performance

	20X2 (CU',000)	20X1 (CU',000)
Revenue from Non-Exchange Transactions		
Taxation Revenue		
Income Tax Revenue (notes 4 and 8)	XXX	XXX
Goods and Services Tax (note 5)	XXX	XXX
Estate Taxes (notes 6 and 9)	XX	XX
Transfer Revenue		
Transfers from Other Governments (note 7)	XXX	XXX
Gifts, Donations, Goods In-kind (note 13)	X	X
Services In-kind (notes 15 and 16)	X	X

Statement of Financial Position

Current Assets		
Cash at Bank	XX	XX
Taxes Receivable		
Goods and Services Taxes Receivable (note 5)	XX	XX
Transfers Receivable		
Transfers receivable from Other Governments (note 7)	X	X
Noncurrent Assets		
Land (note 11)	XXX	XXX
Plant and Equipment (notes 12 and 14)	XX	XX
Current Liabilities		
Liabilities recognized under transfer arrangements (note 10)	XX	XX
Advance Receipts		
Taxes	X	X
Transfers	X	X

Notes to the Financial Statements:

Accounting Policies

Recognition of Revenue from Non-Exchange Transactions

1. Assets and revenue arising from taxation transactions are recognized in accordance with the requirements of IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)." However, the Government takes advantage of the transitional provisions in that Standard in respect of income taxes and estate taxes.

   Apart from income taxes and estate taxes, assets and revenue arising from taxation transactions are recognized in the period in which the taxable event occurs, provided that the assets satisfy the definition of an asset and meet the criteria for recognition as an asset. Income taxes and estate taxes are recognized in the period in which payment for taxation is received (see notes 4 and 6).

2. Assets and revenue arising from transfer transactions are recognized in the period in which the transfer arrangement becomes binding, except for some services in-kind. The government recognizes only those services in-kind that are received as part of an organized program and for which it can determine a fair value by reference to market rates. Other services in-kind are not recognized.

3. Where a transfer is subject to conditions that, if unfulfilled, require the return of the transferred resources, the Government recognizes a liability until the condition is fulfilled.

Basis of Measurement of Major Classes of Revenue from Non-Exchange Transactions

Taxes

4. Income tax revenue is measured at the nominal value of cash, and cash equivalents, received during the reporting period. The Government is currently developing a statistical model for measuring income tax revenue on an accruals basis. This model uses taxation statistics compiled since 19X2 as well as other statistical information including average weekly earnings, gross domestic product and the consumer and producer price indexes. The Government anticipates that the model will enable it to reliably measure income tax revenue on an accruals basis for the reporting period ended December 31, 20X4. The Government does not recognize any amount in respect of income taxes receivable.

5. Assets and revenue accruing from goods and services tax are initially measured at the fair value of assets accruing to the government during the reporting period, principally cash, cash equivalents and goods and services tax receivable. The information is compiled from the goods and services tax returns submitted by taxpayers during the year and other amounts estimated to

be due to the government. Taxpayers have a high compliance rate and a low error rate, using the electronic return system established in 20X0. The high compliance and low error rates have enabled the Government to develop a reliable statistical model for measuring the revenue accruing from the tax.

Goods and services taxes receivable is the estimate of the amount due from taxes attributable to the reporting period that remain unpaid at December 31, 20X2, less a provision for bad debts.

6. Estate tax of 40% is levied on all deceased estates, however the first CU400,000 of each estate is exempt from the tax. Assets and revenue from estate taxes are measured at the nominal value of the cash received during the reporting period, or the fair value as at the date of acquisition of other assets received during the period, as determined by reference to market valuations or by independent appraisal by a member of the valuation profession.

Transfer Revenue

7. Assets and revenue recognized as a consequence of a transfer are measured at the fair value of the assets recognized as at the date of recognition. Monetary assets are measured at their nominal value unless the time value of money is material, in which case present value is used, calculated using a discount rate that reflects the risk inherent in holding the asset. Nonmonetary assets are measured at their fair value, which is determined by reference to observable market values or by independent appraisal by a member of the valuation profession. Receivables are recognized when a binding transfer arrangement is in place but cash or other assets have not been received.

Taxes not Reliably Measurable in the Period in which the Taxable Event Occurs

8. The Government is unable to directly measure the assets arising from income tax during the period in which all taxpayers earn income and is, therefore, taking advantage of the transitional provisions of IPSAS 23, "Revenue from Non-Exchange Transactions (Taxes and Transfers)" to develop a model to indirectly measure taxation revenue in the period in which taxpayers earn income. The government estimates that it will be able to reliably measure income tax on an accruals basis using the model for the reporting period ending December 31, 20X4.

9. In respect of estate taxes, due to current high levels of noncompliance with the law, the government is unable to measure the amount of assets and revenue accruing in the period in which persons owning taxable property die. The government therefore recognizes estate taxes when it receives payment for the tax. The tax department is continuing work to develop a reliable method of measuring the assets receivable and revenue in the year in which the taxable event occurs.

Liabilities Recognized in Respect of Transfers

10. At December 31, 20X2, the Government recognized a liability of CUXX,000 related to a transfer to it conditional upon it building a public hospital. As at December 31, the Government had received a cash payment, however, construction of the hospital had not commenced, although tenders for construction were called for on November 30, 20X2.

Assets Subject to Restrictions

11. Land with a fair value of CUXX,000 was donated during 20X2, subject to the restriction that it be used for public health purposes and not be sold for 50 years. The land was acquired by the transferor at a public auction immediately prior to its transfer and the auction price is the fair value.

12. Plant and equipment includes an amount of CUXX,000, which is the carrying amount of a painting donated in 19X2 to an art gallery controlled by the Government, and subject to the restriction that it not be sold for a period of 40 years. The painting is measured at its fair value, determined by independent appraisal.

Major Classes of Bequests, Gifts, Donations, and Goods In-Kind Received

13. Transfers are received in the form of gifts, donations and goods in-kind – most notably medical and school supplies (inventory), medical and school equipment and works of art (classified as equipment). Gifts and donations are received primarily from private benefactors. Hospitals, schools and art galleries controlled by the Government recognize these assets when control passes to them, usually on receipt of the resources, either cash or plant and equipment. The Government does not accept these transfers with either conditions or restrictions attached unless the value of the transfer exceeds CUXX,000.

14. During 20X2, as part of an external assistance agreement with Government C, computer equipment with a fair value of CUXX,000 was provided to the Government on condition that it be used by the education department or be returned to Government C.

Services In-Kind

15. Hospitals controlled by the government received medical services in-kind from medical practitioners as part of the medical profession’s organized volunteer program. These services in-kind are recognized as revenue and expenses in the statement of financial performance at their fair value as determined by reference to the medical profession’s published schedule of fees.

16. Hospitals, schools and art galleries controlled by the government also received support from volunteers as part of organized programs for art gallery greeters and guides, teachers’ aides and hospital visitor guides. These volunteers provide valuable support to these entities in achieving their

objectives; however, the services provided cannot be reliably measured as there are no equivalent paid positions available in the local markets, and in the absence of volunteers, the services would not be provided. The government does not recognize these services in the statements of financial position or financial performance.

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, IPSAS 23.

BC1. This Basis for Conclusions summarizes the IPSASB's considerations in reaching the conclusions in IPSAS 23. Individual IPSASB members gave greater weight to some factors than to others. In forming their views, IPSASB members considered in depth the views expressed by the Steering Committee on Non-Exchange Revenue in the ITC, "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)" issued in January 2004 and the views expressed by constituents who responded to the consultation on that ITC and the views of respondents to Exposure Draft (ED) 29, "Revenue from Non-Exchange Transactions (Including Taxes and Transfers)."

BC2. In developing this IPSAS, the IPSASB considered the provisions of relevant International Financial Reporting Standards (IFRSs) issued by the International Accounting Standards Board (IASB), in particular International Accounting Standards, IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance" and IAS 41, "Agriculture."

BC3. The IPSASB is cognizant of the project being undertaken by the IASB on revenue recognition and also the IASB's ED "Proposed Amendments to IAS 37, 'Provisions, Contingent Liabilities and Contingent Assets.'" The IPSASB will continue to monitor these projects and, at an appropriate time, consider implications of any changes to IFRSs for IPSASs and IPSASB projects. However, the IPSASB does not consider it appropriate to preempt the outcome of the IASB's due process and anticipate changes to IFRSs. In addition, given the significance of non-exchange revenue to many public sector entities, the IPSASB does not consider that it would be appropriate to defer issuance of this IPSAS pending the outcome of IASB projects.

Background

BC4. Governments and many other public sector entities derive the majority of their revenue from non-exchange transactions. These transactions include, principally, taxation, but also transfers. This IPSAS addresses these types of transactions from the perspective of a public sector entity.

BC5. In 2002, the IPSASB (then the PSC) initiated a project to develop an IPSAS for the recognition and measurement of revenue from non-exchange transactions (including taxes and transfers). The IPSASB established a Steering Committee to develop an ITC to consider the issues related to this issue and make initial recommendations. The Steering Committee was comprised of public sector financial reporting experts from a variety of countries and was chaired by an IPSASB member. An ITC was published in January 2004, with comments requested by June 30, 2004. Fifty-one comments were received. They can be viewed on the IFAC website (www.ifac.org/Guidance/EXD-outstanding). In November 2004, the IPSASB analyzed those comments and began drafting ED 29, which was published in January 2006, with a request for comments by June 30, 2006.

BC6. In November 2006, the IPSASB undertook an in-depth analysis of the responses to ED 29 and prepared this IPSAS and approved it for issue.

Approach

BC7. This standard establishes broad principles for the recognition of revenue from non-exchange transactions and provides guidance on the application of those principles to the major sources of revenue for governments and other public sector entities. In developing this Standard, the IPSASB considered whether to adopt an approach which focused on the development of requirements for accounting for revenue arising from a range of specific types of non-exchange transactions. However, the IPSASB noted and agreed with the views of the Steering Committee that such an approach brings with it consequent risks that the resultant Standard would not provide comprehensive guidance for all revenue from non-exchange transactions. The IPSASB is of the view that the approach adopted in this Standard ensures that appropriate broad principles for the recognition of revenue from non-exchange transactions are established and can be applied to all revenue from non-exchange transactions.

Entity Combinations

BC8. This Standard does not specify whether entity combinations resulting from non-exchange transactions will give rise to revenue. This is because the IPSASB has not considered the financial reporting of entity combinations in the public sector, including the applicability of International Financial Reporting Standard (IFRS) 3, "Business Combinations" to public sector entities.

Monetary and Nonmonetary Assets

BC9. This Standard does not establish different requirements in respect of revenue received or receivable as monetary assets and revenue received or receivable as nonmonetary assets. The IPSASB is of the view that while nonmonetary assets raise additional measurement concerns, these do not, of themselves, justify different financial reporting treatments.

Enforceability of Stipulations

BC10. This Standard defines stipulations, conditions and restrictions as terms in a transfer agreement or legislation or other binding arrangements imposed upon the use of transferred assets. The Standard reflects the view that stipulations, conditions and restrictions must be enforceable to be effective. The ITC and ED 29 also reflected the principle that stipulations imposed on the use of transferred assets are contained in laws, regulations or other binding arrangements, and are by definition enforceable. The IPSASB considers that this principle is necessary to prevent the inappropriate deferment of revenue recognition, or the disclosure of restrictions that have no substance.

Stipulations—Conditions

BC11. This Standard requires that where the transfer of an asset imposes a condition on the recipient, the recipient should recognize a liability in respect of the transfer on initial recognition of the asset. This is because the recipient is unable to avoid an outflow of resources as it is required to consume the future economic benefits or service potential embodied in the transferred asset in the delivery of particular goods or services to third parties as specified, or else to return to the transferor future economic benefits or service potential. Depending on the nature of the condition, it may be fulfilled progressively, permitting the entity to reduce the amount of the liability and recognize revenue progressively, or it may only be fulfilled on the occurrence of a particular future event, in which case the entity eliminates the liability and recognizes revenue when that event occurs.

BC12. Some are of the view that a liability should be recognized only when it is probable that conditions attaching to the inflow of resources will not be satisfied and that future economic benefits or service potential will be required to be returned to the transferor. The IPSASB rejected this proposal because it could result in entities recognizing revenue prematurely, because the entity would recognize the full fair value of the asset as revenue when it initially gains control of the asset, notwithstanding the outflow of resources necessary to satisfy the condition. The financial statements would not, therefore, recognize the present obligation to fulfill the condition imposed by the transfer or return future economic benefits or service potential to the transferor.

Stipulations—Restrictions

BC13. This Standard does not permit entities to recognize a liability in respect of a restriction when the transferred asset is initially recognized. This is because, as defined in this Standard, restrictions do not of themselves impose a present obligation upon the recipient entity to sacrifice future economic benefits or service potential to satisfy the restriction. A breach of a restriction may ultimately lead to a penalty, such as a fine, being imposed upon the recipient entity, however, such a penalty is the result of enforcement procedures resulting from the breach, not from the initial recognition of the asset.

Transactions with Exchange and Non-Exchange Components

BC14. This Standard notes that a single transaction can have two components, an exchange component and a non-exchange component. In these cases, the IPSASB is of the view that the transaction's component parts should be distinguished and recognized separately. Distinguishing the component parts enhances the transparency of financial statements and satisfies the qualitative characteristic of reporting the substance of transactions.

Contributions from Owners

BC15. This Standard identifies examples of some types of documentation that may evidence contributions from owners in the public sector (paragraph 38). Many public sector entities receive inflows of resources from entities that control them, own them or are members of them. In certain circumstances the inflow of resources will be designated as a contribution from owners. Notwithstanding the documentation that evidences the form of the inflow of resources or its designation by a controlling entity, this Standard reflects the view that for an inflow of resources to be classified as a contribution from owners, the substance of the transaction must be consistent with that classification.

Measurement of Assets

BC16. This Standard requires that assets acquired through non-exchange transactions be initially measured at their fair value as at the date of acquisition. The IPSASB is of the view that this is appropriate to reflect the substance of the transaction and its consequences for the recipient. In an exchange transaction the cost of acquisition is a measure of the fair value of the asset acquired. However, by definition, in a non-exchange transaction the consideration provided for the acquisition of an asset is not approximately equal to the fair value of the asset acquired. Fair value most faithfully represents the actual value the public sector entity accrues as a result of the transaction. Initial measurement of assets acquired through non-exchange transactions at their fair value is consistent with the approach taken in IPSAS 16, "Investment Property" and IPSAS 17, "Property, Plant and Equipment" for assets acquired at no cost or for a nominal cost. The IPSASB has made consequential amendments to IPSAS 12, "Inventories" and IPSASs 16 and 17 to fully align those IPSASs with the requirements of this Standard.

Entity Bank Accounts

BC17. This Standard assumes the requirement that all money deposited in a bank account of an entity satisfies the definition of an asset and meets the criteria for recognition of an asset of the entity. The IPSASB established this principle in paragraphs 1.2.6 and 1.2.7 of the Cash Basis IPSAS, "Financial Reporting Under the Cash Basis of Accounting." The Standard also requires the recognition of a liability in respect of any amount the reporting entity has collected and deposited in its own bank account while acting as an agent of another entity.

Measurement of Liabilities

BC18. This Standard requires that where an entity recognizes a liability in respect of an inflow of resources that liability will initially be measured as the best estimate of the amount required to settle the obligation at the reporting date. This measurement basis is consistent with IPSAS 19. The IPSASB is also cognizant of the amendments proposed for IAS 37 (to be retitled "Non-financial Liabilities") on which IPSAS 19 is based, and will monitor, and in due course consider, its response to any developments in IAS 37.

Taxable Event

BC19. This Standard defines a taxable event as the past event that the government, legislature or other authority has determined to be subject to taxation. The Standard notes that this is the earliest possible time to recognize assets and revenue arising from a taxation transaction and is the point at which the past event that gives rise to control of the asset occurs. The IPSASB considered an alternative view that an entity only gains control of resources arising from taxation when those resources are received. Whilst recognizing that there can be difficulties in reliably measuring certain taxation streams, the IPSASB rejected such an approach as inappropriate for the accrual basis of financial reporting.

Advance Receipts

BC20. This Standard requires an entity that receives resources in advance of the taxable event, or of a transfer arrangement becoming enforceable, to recognize an asset and a liability of an equivalent amount. This is consistent with the principles of accrual accounting to recognize revenue in the period in which the underlying event that gives rise to the revenue occurs. In the event that the taxable event did not occur, or the transfer arrangement did not become enforceable, the entity may need to return part or all of the resources. Some are of the view that, where resources are received in advance of the taxable event an entity should only recognize a liability where it considers it probable that there will be a subsequent outflow of resources. The IPSASB supports the view that revenue should not be recognized until the taxable event occurs and extends the principle to transfers, so that where resources are received prior to a transfer arrangement becoming binding, the entity recognizes an asset and a liability for the advance receipt.

Expenses Paid Through the Tax System and Tax Expenditures

BC21. This Standard requires that expenses paid through the tax system be distinguished from tax expenditures, and that the former should be recognized separately from revenue in the general purpose financial statements. This is because, as defined in this Standard, expenses paid through the tax system satisfy the definition of expenses and, according to the principles established in IPSAS 1, offsetting of expenses against revenue is not permitted. As defined in this Standard, tax expenditures are one of the many factors used to determine the amount of tax revenue received or receivable and are not recognized separately from revenue. The IPSASB is of the view that this treatment is consistent with the principles established in this Standard.

BC22. The treatment prescribed in this Standard for expenses paid through the tax system is different to that currently prescribed by the Organization for Economic Co-operation and Development (OECD) for member country statistical returns. The OECD currently requires tax revenue to be shown net of expenses paid through the tax system (or nonwastable tax credits) to the extent that an individual taxpayer's liability for tax is reduced to zero, payments to a taxpayer are shown as expenses.[1] The IPSASB is of the view that the current OECD treatment does not conform to the conceptual principles underpinning the IPSASs and the IPSAS 1 requirement not to offset items of revenue and expense. The statistical financial reporting frameworks are currently under review; in particular, a new edition of the United Nations' *System of National Accounts* is currently under development and is due to be published in 2008. The revised framework may revise the current reporting requirement in respect to tax credits. Revision of the *System of National Accounts* often precedes revisions to other statistical frameworks.

The Tax Gap

BC23. For some taxes, reporting entities will be aware that the amount the government is entitled to collect under the tax law is higher than the amount that will be collected, but will not be able to reliably measure the amount of this difference. The amount collected is lower due to the underground economy (or black market), fraud, evasion, noncompliance with the tax law, and error. The difference between what is legally due under the law and what the government will be able to collect is referred to as the tax gap. Amounts previously included in tax revenue that are determined as not collectible do not constitute part of the tax gap.

BC24. The IPSASB is of the view that the tax gap does not meet the definition of an asset as it is not expected that resources will flow to the government in respect of these amounts. Consequently, assets, liabilities, revenue or expenses will not be recognized in respect of the tax gap.

Services In-Kind

BC25. This Standard permits, but does not require, recognition of services in-kind. This Standard takes the view that many services in-kind do meet the definition of an asset and should, in principle, be recognized. In such cases there may, however, be difficulties in obtaining reliable measurements. In

[1] OECD, *Revenue Statistics* (Paris: OECD, 2000): p. 267, §20-21.

other cases, services in-kind do not meet the definition of an asset because the reporting entity has insufficient control of the services provided. The IPSASB concluded that due to difficulties related to measurement and control, recognition of services in-kind should be permitted but not required.

Compulsory Contributions to Social Security Schemes

BC26. This Standard does not exclude from its scope compulsory contributions to social security schemes that are non-exchange transactions. There are a variety of different arrangements for funding social security schemes in different jurisdictions. Whether or not compulsory contributions to social security schemes give rise to exchange or non-exchange transactions depends on the particular arrangements of a given scheme, and professional judgment is exercised to determine whether the contributions to a social security scheme are recognized in accordance with the principles established in this Standard, or in accordance with principles established in international or national standards addressing such schemes.

December 2006

IPSAS 24—PRESENTATION OF BUDGET INFORMATION IN FINANCIAL STATEMENTS

CONTENTS

International Public Sector Accounting Standard (IPSAS) 24, "Presentation of Budget Information in Financial Statements" is set out in paragraphs 1–55. All the paragraphs have equal authority. IPSAS 24 should be read in the context of its objective, the Basis for Conclusions, and the "Preface to the International Public Sector Accounting Standards." IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

Reasons for Issuing the IPSAS

IN1. Most governments prepare and issue as public documents, or otherwise make publicly available, their financial budgets. The budget documents are widely distributed and promoted. The budget reflects the financial characteristics of the government's plans for the forthcoming period, is a key tool for financial management and control, and is the central component of the process that provides for government and parliamentary (or similar) oversight of the financial dimensions of operations.

IN2. In addition, some individual entities may be required, or may elect, to make publicly available their approved budget(s). In such cases, the entity will also be held publicly accountable for its compliance with, and performance against, its approved budget(s).

IN3. Prior to issue of this International Public Sector Accounting Standard, (IPSAS) IPSAS 1, "Presentation of Financial Statements" encouraged, but did not require, inclusion in the financial statements of a comparison with budgeted amounts where the financial statements and budget are on the same basis. However, the budget(s) for which the entity is held publicly accountable may not be prepared or presented on the same basis as the financial statements. IPSAS 1 did not require or encourage disclosure of a comparison with budget in these circumstances, nor did it provide guidance on the details to be disclosed or the manner of presentation if an entity elected to make such a comparison.

IN4. This Standard identifies disclosures that are to be made by entities which are held publicly accountable for their compliance with, and performance against, their approved budget(s) whether or not the budget and the financial statements are prepared and presented on the same basis.

Main Features of the IPSAS

Applicability

IN5. The Standard applies to public sector entities that make their approved budget(s) publicly available, whether in accordance with legislative or other authoritative requirements imposed on the entity or on a voluntary basis to enhance the transparency of their financial reporting. It requires such entities to make certain disclosures about budget and actual amounts in their financial statements or other reports. It does not require that public sector entities make publicly available their approved budgets, nor does it specify requirements for the formulation or presentation of approved budgets that are made publicly available.

Disclosure

IN6. This Standard requires that the financial statements of public sector entities that make their approved budget(s) publicly available include:

(a) A comparison of actual amounts with amounts in the original and final budget. This comparison is to be made on the same basis of accounting as adopted for the budget, even if that basis is different from the basis adopted for the financial statements. This Standard uses the term actual or actual amount to describe the amounts that result from execution of the budget. In some jurisdictions, budget out-turn, budget execution or similar terms may be used with the same meaning as actual;

(b) An explanation of material differences between budget and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements; and

(c) A reconciliation of actual amounts on a budget basis, with actual amounts presented in the financial statements when the accounting and budget basis differ.

IN7. This IPSAS allows comparison of budget and actual amounts to be made in the financial statements as additional budget columns in the primary financial statements only where the financial statements and the budget are prepared on a comparable basis.

IN8. This IPSAS also requires disclosure of an explanation of the reasons for differences between the original and final budget, including whether those differences arise from reallocations within the budget or other factors such as policy shifts, natural disasters, or other unforeseen events. These disclosures may be made in notes to the financial statements or in a report issued before, in conjunction with, or at the same time as, the financial statements.

IN9. The disclosure of comparative information in respect of the previous period is not required for the disclosures specified by this IPSAS.

IPSAS 24—PRESENTATION OF BUDGET INFORMATION IN FINANCIAL STATEMENTS

Objective

1. This Standard requires a comparison of budget amounts and the actual amounts arising from execution of the budget to be included in the financial statements of entities which are required to, or elect to, make publicly available their approved budget(s) and for which they are, therefore, held publicly accountable. The Standard also requires disclosure of an explanation of the reasons for material differences between the budget and actual amounts. Compliance with the requirements of this Standard will ensure that public sector entities discharge their accountability obligations and enhance the transparency of their financial statements by demonstrating compliance with the approved budget(s) for which they are held publicly accountable and, where the budget(s) and the financial statements are prepared on the same basis, their financial performance in achieving the budgeted results.

Scope

2. **An entity that prepares and presents financial statements under the accrual basis of accounting shall apply this Standard.**

3. **This Standard applies to public sector entities, other than Government Business Enterprises (GBEs), that are required or elect to make publicly available their approved budget(s).**

4. This Standard does not require approved budgets to be made publicly available, nor does it require that the financial statements disclose information about, or make comparisons with, approved budgets which are not made publicly available.

5. In some cases, approved budgets will be compiled to encompass all the activities controlled by a public sector entity. In other cases, separate approved budgets may be required to be made publicly available for certain activities, groups of activities or entities included in the financial statements of a government or other public sector entity. This may occur where, for example, a government's financial statements encompass government agencies or programs that have operational autonomy and prepare their own budgets, or where a budget is prepared only for the general government sector of the whole-of-government. This Standard applies to all entities which present financial statements when approved budgets for the entity, or components thereof, are made publicly available.

6. The "Preface to International Public Sector Accounting Standards" issued by the International Public Sector Accounting Standards Board (IPSASB) explains that Government Business Enterprises (GBEs) apply International Financial Reporting Standards (IFRSs) which are issued by the International

Accounting Standards Board (IASB). GBEs are defined in IPSAS 1, "Presentation of Financial Statements."[1]

Definitions

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

Accounting basis means the accrual or cash basis of accounting as defined in the accrual basis IPSASs and the Cash Basis IPSAS.

Annual budget means an approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.

Appropriation is an authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority.

Approved budget means the expenditure authority derived from laws, appropriation bills, government ordinances and other decisions related to the anticipated revenue or receipts for the budgetary period.

Budgetary basis means the accrual, cash or other basis of accounting adopted in the budget that has been approved by the legislative body.

Comparable basis means the actual amounts presented on the same accounting basis, same classification basis, for the same entities and for the same period as the approved budget.

Final budget is the original budget adjusted for all reserves, carry over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative, or similar authority, changes applicable to the budget period.

Multiyear budget is an approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.

Original budget is the initial approved budget for the budget period.

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

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1 The IPSASB has recently improved and reissued a number of IPSASs. Reference to an IPSAS in this Standard refers to the improved IPSASs issued in December 2006.

Approved Budgets

8. An approved budget as defined by this Standard reflects the anticipated revenues or receipts expected to arise in the annual or multiyear budget period based on current plans and the anticipated economic conditions during that budget period, and expenses or expenditures approved by a legislative body, being the legislature or other relevant authority. An approved budget is not a forward estimate or a projection based on assumptions about future events and possible management actions which are not necessarily expected to take place. Similarly, an approved budget differs from prospective financial information which may be in the form of a forecast, a projection or a combination of both; for example, a one year forecast plus a five year projection.

9. In some jurisdictions, budgets may be signed into law as part of the approval process. In other jurisdictions, approval may be provided without the budget becoming law. Whatever the approval process, the critical feature of approved budgets is that the authority to withdraw funds from the government treasury or similar body for agreed and identified purposes is provided by a higher legislative body or other appropriate authority. The approved budget establishes the expenditure authority for the specified items. The expenditure authority is generally considered the legal limit within which an entity must operate. In some jurisdictions, the approved budget for which the entity will be held accountable may be the original budget and in others it may be the final budget.

10. If a budget is not approved prior to the beginning of the budget period, the original budget is the budget that was first approved for application in the budget year.

Original and Final Budget

11. The original budget may include residual appropriated amounts automatically carried over from prior years by law. For example, governmental budgetary processes in some jurisdictions include a legal provision that requires the automatic rolling forward of appropriations to cover prior year commitments. Commitments encompass possible future liabilities based on a current contractual agreement. In some jurisdictions, they may be referred to as obligations or encumbrances and include outstanding purchase orders and contracts where goods or services have not yet been received.

12. Supplemental appropriations may be necessary where the original budget did not adequately envisage expenditure requirements arising from, for example, war or natural disasters. In addition, there may be a shortfall in budgeted revenues during the period, and internal transfers between budget heads or line items may be necessary to accommodate changes in funding priorities during the fiscal period. Consequently, the funds allotted to an entity or activity may need to be cut back from the amount originally appropriated for

the period in order to maintain fiscal discipline. The final budget includes all such authorized changes or amendments.

Actual Amounts

13. This IPSAS uses the term actual or actual amount to describe the amounts that result from execution of the budget. In some jurisdictions, budget out-turn, budget execution or similar terms may be used with the same meaning as actual or actual amount.

Presentation of a Comparison of Budget and Actual Amounts

14. **Subject to the requirements of paragraph 21, an entity shall present a comparison of the budget amounts for which it is held publicly accountable and actual amounts either as a separate additional financial statement or as additional budget columns in the financial statements currently presented in accordance with IPSASs. The comparison of budget and actual amounts shall present separately for each level of legislative oversight:**

    (a) **The original and final budget amounts;**

    (b) **The actual amounts on a comparable basis; and**

    (c) **By way of note disclosure, an explanation of material differences between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements and a cross reference to those documents is made in the notes.**

15. Presentation in the financial statements of the original and final budget amounts and actual amounts on a comparable basis with the budget which is made publicly available will complete the accountability cycle by enabling users of the financial statements to identify whether resources were obtained and used in accordance with the approved budget. Differences between the actual amounts and the budget amounts, whether original or final budget (often referred to as the variance in accounting), may also be presented in the financial statements for completeness.

16. An explanation of the material differences between actual amounts and the budget amounts will assist users in understanding the reasons for material departures from the approved budget for which the entity is held publicly accountable.

17. An entity may be required, or may elect, to make publicly available its original budget, its final budget or both its original and final budget. In circumstances where both original and final budget are required to be made publicly available, the legislation, regulation or other authority will often

provide guidance on whether explanation of material differences between the actual and the original budget amounts or actual and the final budget amounts is required in accordance with paragraph 14(c). In the absence of any such guidance, material differences may be determined by reference to, for example, differences between actual and original budget to focus on performance against original budget, or differences between actual and final budget to focus on compliance with the final budget.

18. In many cases, the final budget and the actual amount will be the same. This is because budget execution is monitored over the reporting period and the original budget progressively revised to reflect changing conditions, changing circumstances and experiences during the reporting period. Paragraph 29 of this Standard requires the disclosure of an explanation of the reasons for changes between the original and final budget. Those disclosures, together with the disclosures required by paragraph 14 above, will ensure that entities which make publicly available their approved budget(s) are held publicly accountable for their performance against, and compliance with, the relevant approved budget.

19. Management discussion and analysis, operations review or other public reports which provide commentary on the performance and achievements of the entity during the reporting period, including explanations of any material differences from budget amounts, are often issued in conjunction with the financial statements. In accordance with paragraph 14(c) of this Standard, explanation of material differences between actual and budget amounts will be included in notes to the financial statements unless included in other public reports or documents issued in conjunction with the financial statements, and the notes to the financial statements identify the reports or documents in which the explanation can be found.

20. Where approved budgets are only made publicly available for some of the entities or activities included in the financial statements, the requirements of paragraph 14 will apply to only the entities or activities reflected in the approved budget. This means that where, for example, a budget is prepared only for the general government sector of a whole-of-government reporting entity, the disclosures required by paragraph 14 will be made only in respect of the general government sector of the government.

Presentation and Disclosure

21. **An entity shall present a comparison of budget and actual amounts as additional budget columns in the primary financial statements only where the financial statements and the budget are prepared on a comparable basis.**

22. Comparisons of budget and actual amounts may be presented in a separate financial statement, (Statement of Comparison of Budget and Actual Amounts

or a similarly titled statement) included in the complete set of financial statements as specified in IPSAS 1. Alternatively, where the financial statements and the budget are prepared on a comparable basis – that is, on the same basis of accounting for the same entity and reporting period, and adopt the same classification structure – additional columns may be added to the existing primary financial statements presented in accordance with IPSASs. These additional columns will identify original and final budget amounts and, if the entity so chooses, differences between the budget and actual amounts.

23. When the budget and financial statements are not prepared on a comparable basis, a separate Statement of Comparison of Budget and Actual Amounts is presented. In these cases, to ensure that readers do not misinterpret financial information which is prepared on different bases, the financial statements could usefully clarify that the budget and the accounting bases differ and the Statement of Comparison of Budget and Actual Amounts is prepared on the budget basis.

24. In those jurisdictions where budgets are prepared on the accrual basis and encompass the full set of financial statements, additional budget columns can be added to all the primary financial statements required by IPSASs. In some jurisdictions, budgets prepared on the accrual basis may be presented in the form of only certain of the primary financial statements that comprise the full set of financial statements as specified by IPSASs – for example, the budget may be presented as a statement of financial performance or a cash flow statement, with additional information provided in supporting schedules. In these cases, the additional budget columns can be included in the primary financial statements that are also adopted for presentation of the budget.

Level of Aggregation

25. Budget documents may provide great detail about particular activities, programs or entities. These details are often aggregated into broad classes under common budget heads, budget classifications or budget headings for presentation to, and approval by, the legislature or other authoritative body. The disclosure of budget and actual information consistent with those broad classes and budget heads or headings will ensure that comparisons are made at the level of legislative or other authoritative body oversight identified in the budget documents.

26. IPSAS 3 requires financial statements to provide information that meets a number of qualitative characteristics, including that the information is:

(a) Relevant to the decision making needs of users; and

(b) Reliable in that the financial statements:

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

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

(iii) Are neutral, that is, free from bias;

(iv) Are prudent; and

(v) Are complete in all material respects.

27. In some cases, the detailed financial information included in approved budgets may need to be aggregated for presentation in financial statements in accordance with the requirements of this Standard. Such aggregation may be necessary to avoid information overload and to reflect relevant levels of legislative or other authoritative body oversight. Determining the level of aggregation will involve professional judgment. That judgment will be applied in the context of the objective of this Standard and the qualitative characteristics of financial reporting as outlined in paragraph 26 above and Appendix B of IPSAS 1, which summarizes the qualitative characteristics of financial reporting.

28. Additional budget information, including information about service achievements, may be presented in documents other than financial statements. A cross reference from financial statements to such documents is encouraged, particularly to link budget and actual data to nonfinancial budget data and service achievements.

Changes from Original to Final Budget

29. **An entity shall present an explanation of whether changes between the original and final budget are a consequence of reallocations within the budget, or of other factors:**

(a) **By way of note disclosure in the financial statements; or**

(b) **In a report issued before, at the same time as, or in conjunction with the financial statements, and shall include a cross reference to the report in the notes to the financial statements.**

30. The final budget includes all changes approved by legislative actions or other designated authority to revise the original budget. Consistent with the requirements of this Standard, a public sector entity will include in the notes to the financial statements or in a separate report issued before, in conjunction with or at the same time as the financial statements, an explanation of changes between the original and final budget. That explanation will include whether, for example, changes arise as a consequence of reallocations within the original budget parameters or as a consequence of other factors, such as changes in the overall budget parameters, including changes in government policy. Such disclosures are often made in a management discussion and analysis or similar report on operations issued in conjunction with, but not as

part of, the financial statements. Such disclosures may also be included in budget out-turn reports issued by governments to report on budget execution. Where disclosures are made in separate reports rather than in the financial statements, the notes to the financial statements will include a cross reference to the report.

Comparable Basis

31. **All comparisons of budget and actual amounts shall be presented on a comparable basis to the budget.**

32. The comparison of budget and actual amounts will be presented on the same accounting basis (accrual, cash or other basis), same classification basis and for the same entities and period as for the approved budget. This will ensure that the disclosure of information about compliance with the budget in the financial statements is on the same basis as the budget itself. In some cases, this may mean presenting a budget and actual comparison on a different basis of accounting, for a different group of activities, and with a different presentation or classification format than that adopted for the financial statements.

33. Financial statements consolidate entities and activities controlled by the entity. As noted in paragraph 5, separate budgets may be approved and made publicly available for individual entities or particular activities that make up the consolidated financial statements. Where this occurs, the separate budgets may be recompiled for presentation in the financial statements in accordance with the requirements of this Standard. Where such recompilation occurs, it will not involve changes or revisions to approved budgets. This is because this Standard requires a comparison of actual amounts with the approved budget amounts.

34. Entities may adopt different bases of accounting for the preparation of their financial statements and for their approved budgets. For example, a government may adopt the accrual basis for its financial statements and the cash basis for its budget. In addition, budgets may focus on, or include information about, commitments to expend funds in the future and changes in those commitments, while the financial statements will report assets, liabilities, net assets/equity, revenues, expenses, other changes in net assets/equity and cash flows. However, the budget entity and financial reporting entity will often be the same. Similarly, the period for which the budget is prepared and the classification basis adopted for the budget will often be reflected in financial statements. This will ensure that the accounting system records and reports financial information in a manner which facilitates the comparison of budget and actual data for management and for accountability purposes; for example, for monitoring progress of execution of the budget during the budget period and for reporting to the government, the public and other users on a relevant and timely basis.

35. In some jurisdictions, budgets may be prepared on a cash or accrual basis consistent with a statistical reporting system that encompasses entities and activities different from those included in the financial statements. For example, budgets prepared to comply with a statistical reporting system may focus on the general government sector and encompass only entities fulfilling the primary or non-market functions of government as their major activity, while financial statements report on all activities controlled by a government, including the business activities of the government. IPSAS 22, "Disclosure of Financial Information about the General Government Sector" specifies requirements for note disclosure of financial information about the general government sector of a whole-of-government entity which adopts the accrual basis of accounting and elects to make such disclosures. In many cases, disclosures made in accordance with IPSAS 22 will encompass the same entities, activities and classification bases as adopted in budgets prepared consistent with the general government sector as defined in statistical reporting models. In these cases, disclosures made in accordance with IPSAS 22 will also facilitate the disclosures required by this Standard.

36. In statistical reporting models, the general government sector may comprise national, state/provincial and local government levels. In some jurisdictions, the national government may control state/provincial and local governments, consolidate those governments in its financial statements and develop, and require to be made publicly available, an approved budget that encompasses all three levels of government. In these cases, the requirements of this Standard will apply to the financial statements of those national governmental entities. However, where a national government does not control state/provincial or local governments, its financial statements will not consolidate state/provincial or local governments. Rather, separate financial statements are prepared for each level of government. The requirements of this Standard will only apply to the financial statements of governmental entities when approved budgets for the entities and activities they control, or subsections thereof, are made publicly available.

Multiyear Budgets

37. Some governments and other entities approve and make publicly available multiyear budgets, rather than separate annual budgets. Conventionally, multiyear budgets comprise a series of annual budgets or annual budget targets. The approved budget for each component annual period reflects the application of the budgetary policies associated with the multiyear budget for that component period. In some cases, the multiyear budget provides for a roll forward of unused appropriations in any single year.

38. Governments and other entities with multiyear budgets may take different approaches to determining their original and final budget, depending on how their budget is passed. For example, a government may pass a biennial budget

that contains two approved annual budgets, in which case an original and final approved budget for each annual period will be identifiable. If unused appropriations from the first year of the biennial budget are legally authorized to be spent in the second year, the original budget for the second year period will be increased for these carry over amounts. In the rare cases in which a government passes a biennial or other multiperiod budget that does not specifically separate budget amounts into each annual period, judgment may be necessary in identifying which amounts are attributable to each annual period in determining annual budgets for the purposes of this Standard. For example, the original and final approved budget for the first year of a biennial period will encompass any approved capital acquisitions for the biennial period that occurred during the first year, together with the amount of the recurring revenue and expenditure items attributable to that year. The unexpended amounts from the first annual period would then be included in the original budget for the second annual period and that budget together with any amendments thereto would form the final budget for the second year. Where multiperiod budgets are adopted, entities are encouraged to provide additional note disclosure about the relationship between budget and actual amounts during the budget period.

Note Disclosures of Budgetary Basis, Period and Scope

39. **An entity shall explain in notes to the financial statements the budgetary basis and classification basis adopted in the approved budget.**

40. There may be differences between the accounting basis (cash, accrual or some modification thereof) used in preparation and presentation of the budget and the accounting basis used in the financial statements. These differences may occur when the accounting system and the budget system compile information from different perspectives — the budget may focus on cash flows, or cash flows plus certain commitments, while the financial statements report cash flows and accrual information.

41. Formats and classification schemes adopted for presentation of the approved budget may also differ from the formats adopted for the financial statements. An approved budget may classify items on the same basis as is adopted in the financial statements, for example, by economic nature (compensation of employees, use of goods or services, etc.), or function (health, education, etc.). Alternatively, the budget may classify items by specific programs (for example, poverty reduction or control of contagious diseases) or program components linked to performance outcome objectives (for example, students graduating from tertiary education programs or surgical operations performed by hospital emergency services), which differ from classifications adopted in the financial statements. Further, a recurrent budget for ongoing operations (for example, education or health) may be approved separately from a capital budget for capital outlays (for example, infrastructure or buildings).

42. IPSAS 1 requires entities to present in notes to the financial statements, information about the basis of preparation of the financial statements and the significant accounting policies adopted. Disclosure of the budgetary basis and classification basis adopted for the preparation and presentation of approved budgets will assist users to better understand the relationship between the budget and accounting information disclosed in the financial statements.

43. **An entity shall disclose in notes to the financial statements the period of the approved budget.**

44. Financial statements are presented at least annually. Entities may approve budgets for an annual period or for multi-year periods. Disclosure of the period covered by the approved budget, where that period differs from the reporting period adopted for the financial statements, will assist the users of those financial statements to better understand the relationship of the budget data and budget comparison to the financial statements. Disclosure of the period covered by the approved budget, where that period is the same as the period covered by the financial statements, will also serve a useful confirmation role, particularly in jurisdictions where interim budgets and financial statements and reports are also prepared.

45. **An entity shall identify in notes to the financial statements the entities included in the approved budget.**

46. IPSASs require entities to prepare and present financial statements that consolidate all resources controlled by the entity. At the whole-of-government level, financial statements prepared in accordance with IPSASs will encompass budget-dependent entities and GBEs controlled by the government. However, as noted in paragraph 35, approved budgets prepared in accordance with statistical reporting models may not encompass operations of the government that are undertaken on a commercial or market basis. Consistent with the requirements of paragraph 31, budget and actual amounts will be presented on a comparable basis. Disclosure of the entities encompassed by the budget will enable users to identify the extent to which the entity's activities are subject to an approved budget and how the budget entity differs from the entity reflected in the financial statements.

Reconciliation of Actual Amounts on a Comparable Basis and Actual Amounts in the Financial Statements

47. **The actual amounts presented on a comparable basis to the budget in accordance with paragraph 31 shall, where the financial statements and the budget are not prepared on a comparable basis, be reconciled to the following actual amounts presented in the financial statements, identifying separately any basis, timing and entity differences:**

(a) **If the accrual basis is adopted for the budget, total revenues, total expenses and net cash flows from operating activities, investing activities and financing activities; or**

(b) **If a basis other than the accrual basis is adopted for the budget, net cash flows from operating activities, investing activities and financing activities.**

The reconciliation shall be disclosed on the face of the statement of comparison of budget and actual amounts or in the notes to the financial statements.

48. Differences between the actual amounts identified consistent with the comparable basis and the actual amounts recognized in the financial statements can usefully be classified into the following:

(a) Basis differences, which occur when the approved budget is prepared on a basis other than the accounting basis. For example, where the budget is prepared on the cash basis or modified cash basis and the financial statements are prepared on the accrual basis;

(b) Timing differences, which occur when the budget period differs from the reporting period reflected in the financial statements; and

(c) Entity differences, which occur when the budget omits programs or entities that are part of the entity for which the financial statements are prepared.

There may also be differences in formats and classification schemes adopted for presentation of financial statements and the budget.

49. The reconciliation required by paragraph 47 of this Standard will enable the entity to better discharge its accountability obligations by identifying major sources of difference between the actual amounts on a budget basis and the amounts recognized in the financial statements. This Standard does not preclude reconciliation of each major total and subtotal, or each class of items, presented in a comparison of budget and actual amounts with the equivalent amounts in the financial statements.

50. For some entities adopting the same basis of accounting for preparation of both the budget documents and the financial statements, only the identification of differences between actual amounts in the budget and the equivalent amounts in the financial statements will be required. This will occur where the budget is prepared for the same period, encompasses the same entities and adopts the same presentation format as the financial statements. In these cases, a reconciliation is not required. For other entities adopting the same basis of accounting for the budget and the financial statements, there may be a difference in presentation format, reporting entity or reporting period; for example, the approved budget may adopt a different

classification or presentation format to the financial statements, may include only noncommercial activities of the entity, or maybe a multiyear budget. A reconciliation would be necessary where there are presentation, timing or entity differences between the budget and the financial statements prepared on the same accounting basis.

51. For those entities using the cash basis (or a modified cash or modified accrual basis) of accounting for the presentation of the approved budget and the accrual basis for their financial statements, the major totals presented in the statement of budget and actual comparison will be reconciled to net cash flows from operating activities, net cash flows from investing activities, and net cash flows from financing activities as presented in the cash flow statement prepared in accordance with IPSAS 2, “Cash Flow Statements.”

52. **The disclosure of comparative information in respect of the previous period in accordance with the requirements of this Standard is not required.**

53. This Standard requires a comparison of budget and actual amounts to be included in the financial statements of entities which make publicly available their approved budget(s). It does not require the disclosure of a comparison of actuals of the previous period with the budget of that previous period, nor does it require that the related explanations of differences between the actuals and budget of that previous period be disclosed in the financial statements of the current period.

Effective Date

54. **An entity shall apply this IPSAS for annual financial statements covering periods beginning on or after January 1, 2009. Earlier application is encouraged. If an entity applies this Standard for a period beginning before January 1, 2009 it shall disclose that fact.**

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

Implementation Guidance – Illustrative Examples

This guidance accompanies, but is not part of, IPSAS 24.

A. **Statement of Comparison of Budget and Actual Amounts – budget on cash basis**

B. **Additional Column Approach – both annual budget and financial statements on accrual basis**

C. **Extract of Note Disclosures**

D. **Encouraged Note Disclosure: biennial budget on cash basis**

A. Statement of Comparison of Budget and Actual Amounts

For Government XX for The Year Ended December 31, 20XX
Budget On Cash Basis
(Classification Of Payments By Functions)

Note: The budget and the accounting basis is different. This Statement of Comparison of Budget and Actual Amounts is prepared on the budget basis.

(in currency units)	Budgeted Amounts: Original	Budgeted Amounts: Final	Actual Amounts on Comparable Basis	*Difference: Final Budget and Actual* [*]
RECEIPTS				
Taxation	X	X	X	X
Aid Agreements				
International agencies	X	X	X	X
Other Grants and Aid	X	X	X	X
Proceeds: Borrowing	X	X	X	X
Proceeds: Disposal of plant and equipment	X	X	X	X
Trading Activities	X	X	X	X
Other receipts	X	X	X	X
Total receipts	**X**	**X**	**X**	**X**
PAYMENTS				
Health	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)
Public order/safety	(X)	(X)	(X)	(X)
Social protection	(X)	(X)	(X)	(X)
Defense	(X)	(X)	(X)	(X)
Housing and community amenities	(X)	(X)	(X)	(X)
Recreational, cultural and religion	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)

[*] The "Difference…" column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

(in currency units)	Budgeted Amounts Original	 Final	Actual Amounts on Comparable Basis	*Difference: Final Budget and Actual*
Other	(X)	(X)	(X)	(X)
Total payments	**(X)**	**(X)**	**(X)**	**(X)**
NET RECEIPTS/(PAYMENTS)	**X**	**X**	**X**	**X**

B. Additional Column Approach

For Government YY for the Year Ended December 31, 20XX
Both Annual Budget And Financial Statements Adopt Accrual Basis
(Illustrated only for Statement of Financial Performance. Similar presentation would be adopted for other financial statements.)

Actual 20XX-1	(in currency units)	**Actual 20XX**	**Final Budget 20XX**	**Original Budget 20XX**	**Difference: Original Budget and Actual*
	Revenue				
X	Taxes	X	X	X	X
X	Fees, fines, penalties and licenses	X	X	X	X
X	Revenue from exchange transactions	X	X	X	X
X	Transfers from other governments	X	X	X	X
X	Other revenue	X	X	X	X
X	**Total revenue**	**X**	**X**	**X**	**X**
	Expenses				
(X)	Wages, salaries, employee benefits	(X)	(X)	(X)	(X)
(X)	Grants and other transfer payments	(X)	(X)	(X)	(X)
(X)	Supplies and consumables used	(X)	(X)	(X)	(X)
(X)	Depreciation/amortization expense	(X)	(X)	(X)	(X)
(X)	Other expenses	(X)	(X)	(X)	(X)
(X)	Finance costs	(X)	(X)	(X)	(X)
(X)	**Total expenses**	**(X)**	**(X)**	**(X)**	**(X)**
X	Share of surplus of associates	X	X	X	X
X	**Surplus/(deficit) for the period**	**X**	**X**	**X**	**X**
	Attributable to:				

* The "Difference…" column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

Actual 20XX-1	(in currency units)	**Actual 20XX**	**Final Budget 20XX**	**Original Budget 20XX**	**Difference: Original Budget and Actual*
X	Owners of the controlling entity	X	X	X	X
X	Minority interest	X	X	X	X
X		**X**	**X**	**X**	**X**

C. Extract of Note Disclosures ─ for Government X

(Government X presents its approved budget on a cash basis and the financial statements on the accrual basis)

1. The budget is approved on a cash basis by functional classification. The approved budget covers the fiscal period from January 1, 20XX to December 31, 20XX and includes all entities within the general government sector. The general government sector includes all entities identified as government departments in note xx (prepared in accordance with IPSAS 6, "Consolidated and Separate Financial Statements").

2. The original budget was approved by legislative action on (date) and a supplemental appropriation of XXX for disaster relief support was approved by legislative action on (date) due to the earthquake in the Northern Region on (date). The original budget objectives and policies, and subsequent revisions are explained more fully in the Operational Review and Budget Outcomes reports issued in conjunction with the financial statements.

3. The excess of actual expenditure over the final budget of 15% (25% over original budget) for the Health function was due to expenditures above the level approved by legislative action in response to the earthquake. There were no other material differences between the final approved budget and the actual amounts.

4. The budget and the accounting bases differ. The financial statements for the whole-of-government are prepared on the accrual basis using a classification based on the nature of expenses in the statement of financial performance. The financial statements are consolidated statements which include all controlled entities, including government business enterprises for the fiscal period from January 1, 20XX to December 31, 20XX. The financial statements differ from the budget which is approved on the cash basis and which deals only with the general government sector which excludes government business enterprises and certain other non-market government entities and activities.

5. The amounts in the financial statements were recast from the accrual basis to the cash basis and reclassified by functional classification to be on the same basis as the final approved budget. In addition, adjustments to amounts in the financial statements for timing differences associated with the continuing appropriation and differences in the entities covered (government business enterprises) were made to express the actual amounts on a comparable basis to the final approved budget. The amount of these adjustments are identified in the following table.

6. A reconciliation between the actual amounts on a comparable basis as presented in the Statement of Comparison of Budget and Actual Amounts and the actual amounts in the Statement of Cash Flows for the Year Ended

December 31, 20XX is presented below. The financial statements and budget documents are prepared for the same period. There is an entity difference: the budget is prepared for the general government sector and the financial statements consolidate all entities controlled by the government. There is also a basis difference: the budget is prepared on a cash basis and the financial statements on the accrual basis.

	Operating	**Financing**	**Investing**	**Total**
Actual Amount on Comparable Basis as Presented in the Budget and Actual Comparative Statement	**X**	**X**	**X**	**X**
Basis Differences	**X**	**X**	**X**	**X**
Timing Differences	**-**	**-**	**-**	**-**
Entity Differences	**X**	**X**	**X**	**X**
Actual Amount in the Statement of Cash Flows	**X**	**X**	**X**	**X**

(This reconciliation could be included on the face of the Statement of Comparison of Budget and Actual Amounts or as a note disclosure.)

D. Encouraged Note Disclosure: Biennial Budget on Cash Basis – For Government B for the Year Ended December 31, 20XX

(in currency units)	**Original Biennial Budget Year**	**Target Budget for 1st Year**	**Revised Budget in 1st Year**	**1st Year Actual on Comparable Basis**	**Balance Available for 2nd Year**	**Target Budget for 2nd Year**	**Revised Budget in 2nd Year**	**2nd Year Actual on Comparable Basis**	***Difference: Budget and Actual over Budget Period**
RECEIPTS									
Taxation	X	X	X	X	X	X	X	X	X
Aid Agreements	X	X	X	X	X	X	X	X	X
Proceeds: Borrowing	X	X	X	X	X	X	X	X	X
Proceeds: Disposal of plant and equipment	X	X	X	X	X	X	X	X	X
Trading Activities									
Other receipts	X	X	X	X	X	X	X	X	X
Total receipts	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
PAYMENTS									
Health	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Public order and safety	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Social protection	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Defense	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)

* This column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

(in currency units)	**Original Biennial Budget Year**	**Target Budget for 1st Year**	**Revised Budget in 1st Year**	**1st Year Actual on Comparable Basis**	**Balance Available for 2nd Year**	**Target Budget for 2nd Year**	**Revised Budget in 2nd Year**	**2nd Year Actual on Comparable Basis**	**Difference: Budget and Actual over Budget Period*
Housing, community amenities	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Recreational, cultural, religion	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Total payments	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**
NET RECEIPTS/ (PAYMENTS)	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the proposed International Public Sector Accounting Standard.

Scope of the Standard

BC1. In many jurisdictions, legislation or other authority requires public sector entities, whether the government or a particular government entity, to make public the approved budget(s) for which they are held accountable. Such disclosure is required in the interest of transparency of government. In some cases, a government or government entity not subject to such legislation or other authority may voluntarily elect to make its approved budget publicly available. This Standard applies to governments and government entities that make publicly available the approved budget(s) for which they are held accountable.

BC2. The approved budget reflects the financial characteristics of the government's or other entity's plans for the forthcoming period and, in respect of activities funded from the government budget, represent the authority to expend funds. Reporting the results of budget execution against those financial plans will enhance the transparency of financial statements and is an important element in the discharge of accountability of entities which are required to, or elect to, make their budget(s) publicly available. The inclusion of a comparison of budget and actual amounts in financial statements will provide financial information to assist users to assess whether resources were raised as anticipated and used in accordance with the budget(s) approved by the legislature or other authoritative body. This Standard uses the term actual or actual amount to describe the amounts that result from execution of the budget. In other jurisdictions, budget out-turn, budget execution or similar terms may be used with the same meaning as actual or actual amount.

BC3. Many governments and government entities which make publicly available their approved budget(s) already report actual against budgeted amounts in their financial statements. They also include an explanation of material differences between actual and budget in notes to their financial statements or in management discussion and analysis or similar reports or in budget out-turn or similar reports issued in conjunction with their financial statements. For these governments and government entities, comparisons of budget and actual amounts are generally made at the levels of oversight approved by the legislature or similar authority, and explanations of material differences are made where budgetary authority is exceeded. The IPSASB is of the view that this practice is appropriate and has issued this Standard to reinforce the practice, and to require that it be adopted by all entities that make publicly available their approved budgets.

BC4. This Standard does not require entities to make publicly available their approved budgets, or specify presentation requirements for approved budgets that are made publicly available. That is beyond the scope of this Standard. However, the

IPSASB has indicated that in the future it will consider whether an IPSAS should be developed to deal with these matters.

Need for an International Public Sector Accounting Standard

BC5. IPSAS 1 explains that the purpose of financial statements encompasses the disclosure of information to discharge the entity's obligation to be accountable for such matters as its financial position, performance and cash flows and to provide information useful to assess its performance in terms of its service costs, efficiency and accomplishments. It also notes that financial reporting may provide users with information about an entity's compliance with, for example, the legally adopted budget.

BC6. Prior to issue of this Standard, IPSAS 1 encouraged, but did not require, financial statements to include a comparison of budget and actual amounts where the financial statements and the budget are on the same basis. However, in some cases, an entity may make public an approved budget prepared and presented on a different basis to the financial statements and elect to include in financial statements a comparison of actual and budget. IPSAS 1 did not provide guidance on the details to be disclosed or the manner of presentation in such circumstances. The IPSASB is of the view that IPSASs should deal with such circumstances.

BC7. This Standard applies where an entity is required to make publicly available its approved budget(s), or elects to do so. The IPSASB is of the view that in such cases, the intent and effect of the legislature or other authority, or the voluntary action of the entity itself, is clear – the entity is held publicly accountable for its performance against and compliance with the budget. The IPSASB is also of the view that disclosure of information about budget and actual amounts is a necessary element for the discharge of accountability for such entities, and requirements to ensure appropriate disclosure in financial statements should be included in an IPSAS.

BC8. The application of the requirements of this Standard for the disclosure of a comparison of actual and budget amounts where the financial statements and the budget are prepared on the same basis will further enhance the discharge of the entity's accountability for its performance. The application of the requirements of this Standard where the budget and the financial statements are prepared on different bases will reinforce the role of financial statements in discharging the entity's obligation to be accountable for its compliance with approved budgets.

BC9. The IPSASB considered whether it should require or encourage all public sector entities other than GBEs to make publicly available their approved budgets and to comply with the requirements of this Standard. The IPSASB noted that the purpose of this IPSAS was not to specify whether approved budgets should be made publicly available, and agreed that it should not impose such requirements on entities or add to existing encouragements until it had further considered its role in respect of developing requirements for budget reporting. The IPSASB also noted that public sector entities which do not make publicly available their approved budgets are not prohibited from applying the requirements of this Standard if they choose to do so.

Comparisons with approved budget

BC10. This Standard requires disclosure of the original and final budget amounts and actual amounts on a comparable basis with the budget amounts. This reinforces the compliance component of accountability identified in IPSAS 1. Users of the financial statements will be able to identify and determine the differences between amounts in the original and/or final approved budget and their equivalent actual amounts (often referred to as "variances" in accounting) for each level of legislative oversight disclosed.

BC11. This Standard requires an explanation of material differences (whether positive or negative) between actual and budget amounts to be made by way of note disclosure in the financial statements, unless such explanation is included in other publicly available documents issued in conjunction with the financial statements. The IPSASB is of the view that disclosure of this information will enhance the transparency of financial statements and strengthen the accountability of entities that make their budgets publicly available. The explanation of such differences may be included in a management discussion and analysis, operations review, budget out-turn or similar report issued in conjunction with the financial statements. The IPSASB is of the view that where explanation is included in such reports, and notes to the financial statements direct readers to those reports, it is not necessary to repeat that explanation in the financial statements.

Disclosure of original and final budget

BC12. Budgets are prepared in advance of the reporting period and the occurrence of natural disasters and changes in political or economic conditions may dictate a need for revisions to the initially approved budget during the budget period. In some jurisdictions, the authority for such revisions (within specified limits) is delegated to the Minister of Finance or similar office holder. In other jurisdictions, the revisions must be approved by the legislature. Where those revisions are authorized by the appropriate authority, they comprise the final budget for the reporting period. The IPSASB is of the view that disclosure of the original and final budget is necessary to ensure that readers of the financial statements are aware of the nature and extent of changes to the original budget that have been approved during the course of the reporting period.

BC13. Revisions to the original budget may occur as a result of policy shifts, including changes in government priorities during the reporting period, or of unanticipated economic conditions. The IPSASB is of the view that disclosure of an explanation of the reasons for changes between the original and final budget during the reporting period, including whether changes between the original and final budget are a consequence of reallocations within the budget or of other factors, is necessary for the discharge of accountability and will provide useful input for analysis of the financial effects of changing economic conditions and of policy shifts. The explanation may be included in the notes to the financial statements or in a report issued before, at the same time as or in conjunction with the financial statements. As noted above in respect of explanations of budget variances, the IPSASB is of the view that where an explanation is included in such reports, and notes to the financial statements direct readers to those reports, it is not necessary to repeat that explanation in the financial statements.

Adoption of the budget basis and reconciliation of budget and accounting bases

BC14. Entities may adopt different accounting bases for the preparation of their financial statements and for their approved budgets. In particular, some entities that adopt the accrual basis of accounting for preparation of their financial statements prepare their budgets on the cash basis. Differences between the budgetary basis and the financial statements may also arise as a consequence of timing, entity or classification differences.

BC15. This Standard requires that the comparisons of budget and actual amounts be presented on the same basis (format, terminology, budgetary basis and classification) and for the same entities and period as for the approved budget. This is necessary to enable the financial statements to demonstrate the extent to which actual amounts were used in accordance with legally authorized budgets. It will ensure that disclosures are made on a comparable basis, and the financial statements demonstrate compliance with the approved budget. Consequently, amounts reflected in the financial statements will need to be recast to be comparable to the approved budget where there are basis, timing or entity differences.

BC16. To better enable users to identify the relationship between the budget and the financial statements, this Standard requires that when the financial statements and the budget are not prepared on a comparable basis, actual amounts on the budget basis are to be reconciled to specified equivalent amounts presented in the financial statements, identifying separately any basis, timing and entity differences. If the budget and the financial statements are prepared on the same basis, the reconciliation of differences would not be necessary.

Presentation of budget and actual information

BC17. This Standard allows the budget and actual information to be presented in a separate statement or, only when the budget and the financial statements are prepared on a comparable basis, as an additional budget column in existing financial statements. Flexibility in the method of presentation allows entities to present the comparison in a manner that best serves user needs, while at the same time retaining the prominence that comes from inclusion in the financial statements. The prohibition on adopting the additional column approach for presentation when the financial statements and budget are prepared on a different basis of accounting is necessary to ensure that the comparison of budget and actual amounts are presented on a comparable basis.

Initial application

BC18. This Standard was issued by the IPSASB in December 2006. Its application is not required until periods beginning on or after January 1, 2009. The deferred application is intended to provide sufficient time for entities to develop and, as appropriate, align their budget and financial reporting procedures, time periods and coverage. Earlier adoption of this Standard is encouraged.

BC19. The IPSASB considered whether to also provide relief from application of this Standard for two years from initial adoption of IPSASs, but considered that such relief was not necessary. This was because entities would assess, and factor into their timing for initial adoption of all IPSASs, the requirements of this IPSAS.

Relief from the requirement to disclose comparative amounts

BC20. This Standard does not require that the financial statements of the current period include the disclosure of a comparison of actuals of a previous period with the budget of that previous period, nor does it require that the related explanations of differences between the actuals and budget of that previous period be disclosed in the financial statements of the current period.

BC21. The focus of this Standard is on supporting the discharge of the entity’s obligation to be accountable for its compliance with the approved budget for the current reporting period. Many explanatory disclosures required by this IPSAS may be located in other documents issued in conjunction with, but not as part of, the financial statements. The IPSASB is concerned that the requirement for disclosure of comparative information would result in information overload and an over-complex network of reporting requirements, and would not be in the interests of users of the financial statements.

IPSAS 25—EMPLOYEE BENEFITS

Acknowledgment

This International Public Sector Accounting Standard (IPSAS) is drawn primarily from International Accounting Standard (IAS) 19, "Employee Benefits" published by the International Accounting Standards Board (IASB). Extracts from IAS 19 are reproduced in this publication of the International Public Sector Accounting Standards Board (IPSASB) of the International Federation of Accountants (IFAC) with the permission of the International Accounting Standards Committee Foundation (IASCF).

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IPSAS 25—EMPLOYEE BENEFITS

CONTENTS

IPSAS 25, "Employee Benefits" is set out in paragraphs 1–177. All the paragraphs have equal authority except as noted otherwise. IPSAS 25 should be read in the context of its objective, the Basis for Conclusions, and the "Preface to International Public Sector Accounting Standards." IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors" provides a basis for selecting and applying accounting policies in the absence of explicit guidance.

Introduction

IN1. The Standard prescribes the accounting and disclosure by public sector entities for employee benefits. It is based on IAS 19, "Employee Benefits." The Standard does not deal with accounting and reporting by retirement benefit plans (see the relevant international or national accounting standard dealing with accounting and reporting by retirement benefit plans). Benefits that are not consideration in exchange for service rendered by employees or past employees of reporting entities are not within the scope of this Standard.

IN2. The Standard deals with four categories of employee benefits:

(a) Short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

(b) Postemployment benefits such as pensions, other retirement benefits, postemployment life insurance and postemployment medical care;

(c) Other long-term employee benefits, which may include long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are payable twelve months or more after the end of the period, performance related bonuses, profit-sharing bonuses and deferred compensation; and

(d) Termination benefits.

IN3. Benefits in all these categories are commonplace for public sector entities globally.

IN4. The Standard requires an entity to recognize short-term employee benefits when an employee has rendered service in exchange for those benefits.

IN5. Postemployment benefit plans are classified as either defined contribution plans or defined benefit plans. The Standard gives specific guidance on the classification of multi-employer plans, state plans, composite social security programs and plans with insured benefits. The Standard also provides guidance for entities participating in defined benefit plans, where the entities are under common control.

IN6. Under defined contribution plans, an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods. The Standard requires an entity to recognize contributions to a defined contribution plan when an employee has rendered service in exchange for those contributions.

IN7. All other postemployment benefit plans are defined benefit plans. Defined benefit plans may be unfunded, or they may be wholly or partly funded. The Standard requires an entity to:

(a) Account not only for its legal obligation, but also for any constructive obligation that arises from the entity's practices;

(b) Determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the reporting date;

(c) Use the Projected Unit Credit Method to measure its obligations and costs;

(d) Attribute benefit to periods of service under the plan's benefit formula, unless an employee's service in later years will lead to a materially higher level of benefit than in earlier years;

(e) Use unbiased and mutually compatible actuarial assumptions about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries, changes in medical costs and relevant changes in state benefits). Financial assumptions should be based on market expectations, at the reporting date, for the period over which the obligations are to be settled;

(f) Determine a rate to discount postemployment benefit obligations (both funded and unfunded) that reflects the time value of money. The currency and term of the financial instrument selected to reflect the time value of money shall be consistent with the currency and estimated term of the postemployment benefit obligations;

(g) Deduct the fair value of any plan assets from the carrying amount of the obligation. Certain reimbursement rights that do not qualify as plan assets are treated in the same way as plan assets, except that they are presented as a separate asset, rather than as a deduction from the obligation;

(h) Limit the carrying amount of an asset so that it does not exceed the net total of:

(i) Any unrecognized past service cost and actuarial losses; plus

(ii) The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan;

(i) Recognize past service cost on a straight-line basis over the average period until the amended benefits become vested;

(j) Recognize gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss should comprise any resulting change in the present value of the defined benefit obligation and of the fair value of the plan assets and the unrecognized part of any related actuarial gains and losses and past service cost; and

(k) Recognize a specified portion of the net cumulative actuarial gains and losses that exceed the greater of:

(i) 10% of the present value of the defined benefit obligation (before deducting plan assets); and

(ii) 10% of the fair value of any plan assets.

The portion of actuarial gains and losses to be recognized for each defined benefit plan is the excess that fell outside the 10% corridor at the previous reporting date, divided by the expected average remaining working lives of the employees participating in that plan.

The Standard also permits systematic methods of faster recognition, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. Such permitted methods include immediate recognition of all actuarial gains and losses in surplus or deficit. In addition, the Standard permits an entity to recognize all actuarial gains and losses in the period in which they occur outside surplus or deficit in the statement of changes in net assets/equity for the year in accordance with paragraph 118(b) of IPSAS 1.

IN8. The Standard requires a simpler method of accounting for other long-term employee benefits than for postemployment benefits: actuarial gains and losses and past service cost are recognized immediately. The Standard includes a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of postemployment benefits. Where this presumption is rebutted the entity considers whether some or all long-term disability payments should be accounted for in accordance with the requirements for postemployment benefits.

IN9. Termination benefits are employee benefits payable as a result of either: an entity's decision to terminate an employee's employment before the normal retirement date; or an employee's decision to accept voluntary redundancy in exchange for those benefits. The event which gives rise to an obligation is the termination rather than employee service. Therefore, an entity should recognize termination benefits when, and only when, the entity is demonstrably committed to either:

(a) Terminate the employment of an employee or group of employees before the normal retirement date; or

(b) Provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.

IN10. An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan (with specified minimum contents) for the termination and is without realistic possibility of withdrawal.

IN11. Where termination benefits fall due more than 12 months after the reporting date, they should be discounted. In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits should be based on the number of employees expected to accept the offer.

Objective

1. The objective of this Standard is to prescribe the accounting and disclosure for employee benefits. The Standard requires an entity to recognize:

   (a) A liability when an employee has provided service in exchange for employee benefits to be paid in the future; and

   (b) An expense when the entity consumes the economic benefits or service potential arising from service provided by an employee in exchange for employee benefits.

Scope

2. **This Standard shall be applied by an employer in accounting for all employee benefits, except share based transactions (see the relevant international or national accounting standard dealing with share based transactions).**

3. This Standard does not deal with reporting by employee retirement benefit plans (see the relevant international or national accounting standard dealing with employee retirement benefit plans). This Standard does not deal with benefits provided by composite social security programs that are not consideration in exchange for service rendered by employees or past employees of public sector entities.

4. The employee benefits to which this Standard applies include those provided:

   (a) Under formal plans or other formal agreements between an entity and individual employees, groups of employees or their representatives;

   (b) Under legislative requirements, or through industry arrangements, whereby entities are required to contribute to national, state, industry, or other multi-employer plans or where entities are required to contribute to the composite social security program; or

   (c) By those informal practices that give rise to a constructive obligation. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.

5. Employee benefits include:

   (a) Short-term employee benefits, such as wages, salaries and social security contributions, paid annual leave and paid sick leave, profit-sharing and bonuses (if payable within twelve months of the end of the period) and non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees;

   (b) Postemployment benefits such as pensions, other retirement benefits, postemployment life insurance and postemployment medical care;

   (c) Other long-term employee benefits, which may include long-service leave or sabbatical leave, jubilee or other long-service benefits, long-term disability benefits and, if they are not payable wholly within twelve months after the end of the period, profit-sharing, bonuses and deferred compensation; and

   (d) Termination benefits.

   Because each category identified in (a)-(d) above has different characteristics, this Standard establishes separate requirements for each category.

6. Employee benefits include benefits provided to either employees or their dependants and may be settled by payments (or the provision of goods or services) made either directly to the employees, to their spouses, children or other dependants or to others, such as insurance companies.

7. An employee may provide services to an entity on a full-time, part-time, permanent, casual or temporary basis. For the purpose of this Standard, employees include key management personnel as defined in IPSAS 20, “Related Party Disclosures.”

8. **This Standard applies to all public sector entities other than Government Business Enterprises.**

9. The “Preface to International Financial Reporting Standards” issued by the IASB explains that IFRS are designed to apply to the general purpose financial statements of all profit oriented entities. Government Business Enterprises (GBEs) are profit oriented entities. Accordingly, they are required to comply with IFRSs.

Definitions

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

    <u>Actuarial gains and losses</u> comprise:

(a) **Experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and**

(b) **The effects of changes in actuarial assumptions.**

Assets held by a long-term employee benefit fund are assets (other than non-transferable financial instruments issued by the reporting entity) that:

(a) **Are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and**

(b) **Are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either:**

   (i) **The remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or**

   (ii) **The assets are returned to the reporting entity to reimburse it for employee benefits already paid.**

Composite social security programs are established by legislation; and

(a) **Operate as multi-employer plans to provide postemployment benefits; as well as to**

(b) **Provide benefits that are not consideration in exchange for service rendered by employees.**

Current service cost is the increase in the present value of the defined benefit obligation resulting from employee service in the current period.

Defined benefit plans are postemployment benefit plans other than defined contribution plans.

Defined contribution plans are postemployment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.

Employee benefits are all forms of consideration given by an entity in exchange for service rendered by employees.

Interest cost is the increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.

Multiemployer plans are defined contribution plans (other than state plans and composite social security programs) or defined benefit plans (other than state plans) that:

(a) **Pool the assets contributed by various entities that are not under common control; and**

(b) **Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.**

Other long-term employee benefits are employee benefits (other than postemployment benefits and termination benefits) which do not fall due wholly within twelve months after the end of the period in which the employees render the related service.

Past service cost is the increase in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, postemployment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).

Plan assets comprise:

(a) **Assets held by a long-term employee benefit fund; and**

(b) **Qualifying insurance policies.**

Postemployment benefits are employee benefits (other than termination benefits) which are payable after the completion of employment.

Postemployment benefit plans are formal or informal arrangements under which an entity provides postemployment benefits for one or more employees.

The present value of a defined benefit obligation is the present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.

A qualifying insurance policy is an insurance policy* issued by an insurer that is not a related party (as defined in IPSAS 20) of the reporting entity, if the proceeds of the policy:

(a) **Can be used only to pay or fund employee benefits under a defined benefit plan; and**

* A qualifying insurance policy is not necessarily an insurance contract (see the relevant international or national standard dealing with insurance contracts).

(b) **Are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either:**

  (i) **The proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or**

  (ii) **The proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.**

The <u>return on plan assets</u> is interest, dividends and other revenue derived from the plan assets, together with realized and unrealized gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself.

<u>Short-term employee benefits</u> are employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service.

<u>State plans</u> are plans other than composite social security programs established by legislation which operate as if they are multi-employer plans for all entities in economic categories laid down in legislation.

Termination benefits are employee benefits payable as a result of either:

(a) **An entity's decision to terminate an employee's employment before the normal retirement date; or**

(b) **An employee's decision to accept voluntary redundancy in exchange for those benefits.**

<u>Vested employee benefits</u> are employee benefits that are not conditional on future employment.

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

Short-Term Employee Benefits

11. Short-term employee benefits include items such as:

  (a) Wages, salaries and social security contributions;

  (b) Short-term compensated absences (such as paid annual leave and paid sick leave) where the absences are expected to occur within twelve months after the end of the period in which the employees render the related employee service;

(c) Performance related bonuses and profit-sharing payable within twelve months after the end of the period in which the employees render the related service; and

(d) Non-monetary benefits (such as medical care, housing, cars and free or subsidised goods or services) for current employees.

12. Accounting for short-term employee benefits is generally straightforward because no actuarial assumptions are required to measure the obligation or the cost and there is no possibility of any actuarial gain or loss. Moreover, short-term employee benefit obligations are measured on an undiscounted basis.

Recognition and Measurement

All Short-Term Employee Benefits

13. **When an employee has rendered service to an entity during an accounting period, the entity shall recognize the undiscounted amount of short-term employee benefits expected to be paid in exchange for that service:**

(a) **As a liability (accrued expense), after deducting any amount already paid. If the amount already paid exceeds the undiscounted amount of the benefits, an entity shall recognize that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and**

(b) **As an expense, unless another Standard requires or permits the inclusion of the benefits in the cost of an asset (see, for example, IPSAS 12, "Inventories" and IPSAS 17, "Property, Plant and Equipment."**

Paragraphs 14, 17 and 20 explain how an entity shall apply this requirement to short-term employee benefits in the form of compensated absences and bonus and profit-sharing plans.

Short-Term Compensated Absences

14. **An entity shall recognize the expected cost of short-term employee benefits in the form of compensated absences under paragraph 13 as follows:**

(a) **In the case of accumulating compensated absences, when the employees render service that increases their entitlement to future compensated absences; and**

(b) **In the case of non-accumulating compensated absences, when the absences occur.**

15. An entity may compensate employees for absence for various reasons including vacation, sickness and short-term disability, maternity or paternity, jury service and military service. Entitlement to compensated absences falls into two categories:

(a) Accumulating; and

(b) Non-accumulating.

16. Accumulating compensated absences are those that are carried forward and can be used in future periods if the current period's entitlement is not used in full. Accumulating compensated absences may be either vesting (in other words, employees are entitled to a cash payment for unused entitlement on leaving the entity) or non-vesting (when employees are not entitled to a cash payment for unused entitlement on leaving). An obligation arises as employees render service that increases their entitlement to future compensated absences. The obligation exists, and is recognized, even if the compensated absences are non-vesting, although the possibility that employees may leave before they use an accumulated non-vesting entitlement affects the measurement of that obligation.

17. **An entity shall measure the expected cost of accumulating compensated absences as the additional amount that the entity expects to pay as a result of the unused entitlement that has accumulated at the reporting date.**

18. The method specified in paragraph 17 measures the obligation at the amount of the additional payments that are expected to arise solely from the fact that the benefit accumulates. In many cases, an entity may not need to make detailed computations to estimate that there is no material obligation for unused compensated absences. For example, a sick leave obligation is likely to be material only if there is a formal or informal understanding that unused paid sick leave may be taken as paid vacation.

19. Non-accumulating compensated absences do not carry forward: they lapse if the current period's entitlement is not used in full and do not entitle employees to a cash payment for unused entitlement on leaving the entity. This is commonly the case for sick pay (to the extent that unused past entitlement does not increase future entitlement), maternity or paternity leave and compensated absences for jury service or military service. An entity recognizes no liability or expense until the time of the absence, because employee service does not increase the amount of the benefit.

Bonus Payments and Profit-Sharing Payments

20. **An entity shall recognize the expected cost of bonus payments and profit-sharing payments under paragraph 13 when, and only when:**

(a) **The entity has a present legal or constructive obligation to make such payments as a result of past events; and**

(b) **A reliable estimate of the obligation can be made.**

A present obligation exists when, and only when, the entity has no realistic alternative but to make the payments.

21. In the public sector some entities have bonus plans that are related to service delivery objectives or aspects of financial performance. Under such plans employees receive specified amounts, dependent on an assessment of their contribution to the achievement of the objectives of the entity or a segment of the entity. In some cases such plans may be for groups of employees, such as when performance is evaluated for all or some employees in a particular segment, rather than on an individual basis. Because of the objectives of public sector entities, profit sharing plans are far less common in the public sector than for profit-oriented entities. However, they are likely to be an aspect of employee remuneration in segments of public sector entities that operate on a commercial basis. Some public sector entities may not operate profit-sharing schemes, but may evaluate performance against financially based measures such as the generation of revenue streams and the achievement of budgetary targets. Some bonus plans may entail payments to all employees who rendered employment services in a reporting period, even though they may have left the entity before the reporting date. However, under other bonus plans, employees receive payments only if they remain with the entity for a specified period, for example, a requirement that employees render services for the whole of the reporting period. Such plans create a constructive obligation as employees render service that increases the amount to be paid if they remain in service until the end of the specified period. The measurement of such constructive obligations reflects the possibility that some employees may leave without receiving profit-sharing payments. Paragraph 23 provides further conditions that are to be satisfied before an entity can recognize the expected cost of performance-related payments, bonus payments and profit-sharing payments.

22. An entity may have no legal obligation to pay a bonus. Nevertheless, in some cases, an entity has a practice of paying bonuses. In such cases, the entity has a constructive obligation because the entity has no realistic alternative but to pay the bonus. The measurement of the constructive obligation reflects the possibility that some employees may leave without receiving a bonus.

23. An entity can make a reliable estimate of its legal or constructive obligation under a performance-related payment scheme, bonus plan or profit-sharing scheme when, and only when:

    (a) The formal terms of the plan contain a formula for determining the amount of the benefit;

    (b) The entity determines the amounts to be paid before the financial statements are authorized for issue; or

    (c) Past practice gives clear evidence of the amount of the entity's constructive obligation.

24. An obligation under bonus plans and profit-sharing plans results from employee service and is recognized as an expense in surplus or deficit.

25. If bonus payments and profit shares are not due wholly within twelve months after the end of the period in which the employees render the related service, those payments are other long-term employee benefits (see paragraphs 147–153).

Disclosure

26. Although this Standard does not require specific disclosures about short-term employee benefits, other Standards may require disclosures. For example, IPSAS 20 requires disclosures of the aggregate remuneration of key management personnel and IPSAS 1, "Presentation of Financial Statements" requires the disclosure of information about employee benefits.

Postemployment Benefits: Distinction between Defined Contribution Plans and Defined Benefit Plans

27. Postemployment benefits include, for example:

    (a) Retirement benefits, such as pensions; and

    (b) Other postemployment benefits, such as postemployment life insurance and postemployment medical care.

    Arrangements whereby an entity provides postemployment benefits are postemployment benefit plans. An entity applies this Standard to all such arrangements whether or not they involve the establishment of a separate entity, such as a pension scheme, superannuation scheme or retirement benefit scheme, to receive contributions and to pay benefits.

28. Postemployment benefit plans are classified as either defined contribution plans or defined benefit plans, depending on the economic substance of the plan as derived from its principal terms and conditions. In order to be classified as a defined contribution plan a postemployment benefit plan must require the entity to pay fixed contributions into a separate entity. Under defined contribution plans:

    (a) The entity's legal or constructive obligation is limited to the amount that it agrees to contribute to the fund. Thus, the amount of the postemployment benefits received by the employee is determined by the amount of contributions paid by an entity (and perhaps also the employee) to a postemployment benefit plan or to an insurance company, together with investment returns arising from the contributions; and

    (b) In consequence, actuarial risk (that benefits will be less than expected) and investment risk (that assets invested will be insufficient to meet expected benefits) fall on the employee.

29. Examples of cases where an entity's obligation is not limited to the amount that it agrees to contribute to the fund are when the entity has a legal or constructive obligation through:

    (a) A plan benefit formula that is not linked solely to the amount of contributions;

    (b) A guarantee, either indirectly through a plan or directly, of a specified return on contributions; or

    (c) Those informal practices that give rise to a constructive obligation. For example, a constructive obligation may arise where an entity has a history of increasing benefits for former employees to keep pace with inflation even where there is no legal obligation to do so.

30. Under defined benefit plans:

    (a) The entity's obligation is to provide the agreed benefits to current and former employees; and

    (b) Actuarial risk (that benefits will cost more than expected) and investment risk fall, in substance, on the entity. If actuarial or investment experience are worse than expected, the entity's obligation may be increased.

31. Unlike defined contribution plans, the definition of a defined benefit plan does not require the payment of contributions to a separate entity. Paragraphs 32–53 below explain the distinction between defined contribution plans and defined benefit plans in the context of multi-employer plans, state plans, composite social security programs and insured benefits.

Multi-Employer Plans

32. **An entity shall classify a multi-employer plan as a defined contribution plan or a defined benefit plan under the terms of the plan (including any constructive obligation that goes beyond the formal terms). Where a multi-employer plan is a defined benefit plan, an entity shall:**

    (a) **Account for its proportionate share of the defined benefit obligation, plan assets and cost associated with the plan in the same way as for any other defined benefit plan; and**

    (b) **Disclose the information required by paragraph 141.**

33. **When sufficient information is not available to use defined benefit accounting for a multi-employer plan that is a defined benefit plan, an entity shall:**

    (a) **Account for the plan under paragraphs 55–57 as if it were a defined contribution plan;**

(b) **Disclose:**

  (i) **The fact that the plan is a defined benefit plan; and**

  (ii) **The reason why sufficient information is not available to enable the entity to account for the plan as a defined benefit plan; and**

(c) **To the extent that a surplus or deficit in the plan may affect the amount of future contributions, disclose in addition:**

  (i) **Any available information about that surplus or deficit;**

  (ii) **The basis used to determine that surplus or deficit; and**

  (iii) **The implications, if any, for the entity.**

34. One example of defined benefit multi-employer plan is where:

(a) The plan is financed on a pay-as-you-go basis such that: contributions of employers and/or employees are set at a level that is expected to be sufficient to pay the benefits falling due in the same period; and future benefits earned during the current period will be paid out of future contributions; and

(b) Employees' benefits are determined by the length of their service and the participating entities have no realistic means of withdrawing from the plan without paying a contribution for the benefits earned by employees up to the date of withdrawal.

Such a plan creates actuarial risk for the entity: if the ultimate cost of benefits already earned at the reporting date is more than expected, the entity will have to either increase its contributions or persuade employees to accept a reduction in benefits. Therefore, such a plan is a defined benefit plan.

35. Where sufficient information is available about a multi-employer plan that is a defined benefit plan, an entity accounts for its proportionate share of the defined benefit obligation, plan assets and postemployment benefit cost associated with the plan in the same way as for any other defined benefit plan. However, there may be cases where an entity may not be able to identify its share of the underlying financial position and performance of the plan with sufficient reliability for accounting purposes. This may occur if:

(a) The entity does not have access to information about the plan that satisfies the requirements of this Standard; or

(b) The plan exposes the participating entities to actuarial risks associated with the current and former employees of other entities, with the result that there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual entities participating in the plan.

In those cases, an entity accounts for the plan as if it were a defined contribution plan and discloses the additional information required by paragraph 33.

36. There may be a contractual agreement between the multi-employer plan and its participant entities that determines how the surplus in the plan will be distributed to the participant entities (or the deficit funded). A participant in a multi-employer plan with such an agreement that accounts for the plan as a defined contribution plan in accordance with paragraph 33 recognizes the asset or liability that arises from the contractual agreement and the resulting revenue or expense in surplus or deficit.

37. IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets" requires an entity to recognize, or disclose information about, certain contingent liabilities. In the context of a multi-employer plan, a contingent liability may arise from, for example:

   (a) Actuarial losses relating to other participating entities because each entity that participates in a multi-employer plan shares in the actuarial risks of every other participating entity; or

   (b) Any responsibility under the terms of a plan to finance any shortfall in the plan if other entities cease to participate.

38. Multi-employer plans are distinct from group administration plans. A group administration plan is merely an aggregation of single employer plans combined to allow participating employers to pool their assets for investment purposes and reduce investment management and administration costs, but the claims of different employers are segregated for the sole benefit of their own employees. Group administration plans pose no particular accounting problems because information is readily available to treat them in the same way as any other single employer plan and because such plans do not expose the participating entities to actuarial risks associated with the current and former employees of other entities. The definitions in this Standard require an entity to classify a group administration plan as a defined contribution plan or a defined benefit plan in accordance with the terms of the plan (including any constructive obligation that goes beyond the formal terms).

Defined Benefit Plans where the Participating Entities are under Common Control

39. Defined benefit plans that share risks between various entities under common control, for example, controlling and controlled entities, are not multi-employer plans.

40. An entity participating in such a plan obtains information about the plan as a whole measured in accordance with this Standard on the basis of assumptions that apply to the plan as a whole. If there is a contractual agreement, binding arrangement or stated policy for charging the net defined benefit cost for the

plan as a whole measured in accordance with this Standard to individual entities within the economic entity, the entity shall, in its separate or individual financial statements, recognize the net defined benefit cost so charged. If there is no such agreement, arrangement or policy, the net defined benefit cost shall be recognized in the separate or individual financial statements of the entity that is legally the sponsoring employer for the plan. The other entities shall, in their separate or individual financial statements, recognize a cost equal to their contribution payable for the period.

41. There are cases in the public sector where a controlling entity and one or more controlled entities participate in a defined benefit plan. Unless there is a contractual agreement, binding arrangement or stated policy, as specified in paragraph 40, the controlled entity accounts on a defined contribution basis and the controlling entity accounts on a defined benefit basis in its consolidated financial statements. The controlled entity also discloses that it accounts on a defined contribution basis in its separate financial statements. A controlled entity that accounts on a defined contribution basis also provides details of the controlling entity, and states that, in the controlling entity's consolidated financial statements, accounting is on a defined benefit basis. The controlled entity also makes the disclosures required in paragraph 42.

42. **Participation in such a plan is a related party transaction for each individual entity. An entity shall therefore, in its separate or individual financial statements, make the following disclosures:**

    (a) **The contractual agreement, binding arrangement or stated policy for charging the net defined benefit cost or the fact that there is no such policy.**

    (b) **The policy for determining the contribution to be paid by the entity.**

    (c) **If the entity accounts for an allocation of the net defined benefit cost in accordance with paragraph 40, all the information about the plan as a whole in accordance with paragraphs 140–142.**

    (d) **If the entity accounts for the contribution payable for the period in accordance with paragraph 40, the information about the plan as a whole required in accordance with paragraphs 141(b)–(e), (j), (n), (o), (q) and 142. The other disclosures required by paragraph 141 do not apply.**

State Plans

43. **An entity shall account for postemployment benefits under state plans in the same way as for a multi-employer plan (see paragraphs 32 and 33).**

44. State plans are established by legislation to cover all entities (or all entities in a particular category, for example, a specific industry) and are operated by national, state or local government or by another body (for example, an

agency created specifically for this purpose). This Standard deals only with employee benefits of the entity and does not address accounting for any obligations under state plans related to employees and past employees of entities that are not controlled by the reporting entity. While governments may establish state plans and provide benefits to employees of private sector entities and/or self-employed individuals, obligations arising in respect of such plans are not addressed in this Standard.

45. Many state plans are funded on a pay-as-you-go basis: contributions are set at a level that is expected to be sufficient to pay the required benefits falling due in the same period; future benefits earned during the current period will be paid out of future contributions. Entities covered by state plans account for those plans as either defined contribution or defined benefit plans. The accounting treatment depends upon whether the entity has a legal or constructive obligation to pay future benefits. If an entity's only obligation is to pay the contributions as they fall due and the entity has no obligation to pay future benefits, it accounts for that state plan as a defined contribution plan.

46. A state plan may be classified as a defined contribution plan by a controlled entity. However, it is a rebuttable presumption that the state plan will be characterized as a defined benefit plan by the controlling entity. Where that presumption is rebutted the state plan is accounted for as a defined contribution plan.

Composite Social Security Programs

47. **A reporting entity shall account for postemployment benefits under composite social security programs in the same way as for a multi-employer plan (see paragraphs 32 and 33).**

48. Composite social security programs are established by legislation and provide benefits to individuals who have satisfied eligibility criteria. Such criteria principally include a requirement that an individual has attained a retirement age laid down in legislation. There may also be other criteria related to factors such as income and personal wealth. In some jurisdictions the composite social security program may also operate to provide benefits as consideration in exchange for employment services rendered by individuals. This Standard only addresses obligations in composite social security programs which arise as consideration in exchange for service rendered by employees and past employees of the reporting entity. This Standard requires a reporting entity to account for obligations for employee benefits that arise under composite social security programs as for a multi-employer plan in accordance with paragraphs 32 and 33.

49. For an economic entity, such as the whole-of-government level, the accounting treatment for obligations for employee benefits under composite social security programs depends upon whether the component of that program operating to

provide postemployment benefits to employees of the economic entity is characterized as a defined contribution or a defined benefit plan. In making this judgment the factors highlighted in paragraph 35 are considered.

Insured Benefits

50. **An entity may pay insurance premiums to fund a postemployment benefit plan. The entity shall treat such a plan as a defined contribution plan unless the entity will have (either directly or indirectly through the plan) a legal or constructive obligation to either:**

    (a) **Pay the employee benefits directly when they fall due; or**

    (b) **Pay further amounts if the insurer does not pay all future employee benefits relating to employee service in the current and prior periods.**

    If the entity retains such a legal or constructive obligation, the entity shall treat the plan as a defined benefit plan.

51. The benefits insured by an insurance contract need not have a direct or automatic relationship with the entity's obligation for employee benefits. Postemployment benefit plans involving insurance contracts are subject to the same distinction between accounting and funding as other funded plans.

52. Where an entity funds a postemployment benefit obligation by contributing to an insurance policy under which the entity (either directly, indirectly through the plan, through the mechanism for setting future premiums or through a related party relationship with the insurer) retains a legal or constructive obligation, the payment of the premiums does not amount to a defined contribution arrangement. It follows that the entity:

    (a) Accounts for a qualifying insurance policy as a plan asset (see paragraph 10); and

    (b) Recognizes other insurance policies as reimbursement rights (if the policies satisfy the criteria in paragraph 121).

53. Where an insurance policy is in the name of a specified plan participant or a group of plan participants and the entity does not have any legal or constructive obligation to cover any loss on the policy, the entity has no obligation to pay benefits to the employees and the insurer has sole responsibility for paying the benefits. The payment of fixed premiums under such contracts is, in substance, the settlement of the employee benefit obligation, rather than an investment to meet the obligation. Consequently, the entity no longer has an asset or a liability. Therefore, an entity treats such payments as contributions to a defined contribution plan.

Postemployment Benefits—Defined Contribution Plans

54. Accounting for defined contribution plans is straightforward because the reporting entity's obligation for each period is determined by the amounts to be contributed for that period. Consequently, no actuarial assumptions are required to measure the obligation or the expense and there is no possibility of any actuarial gain or loss. Moreover, the obligations are measured on an undiscounted basis, except where they do not fall due wholly within twelve months after the end of the period in which the employees render the related service.

Recognition and Measurement

55. **When an employee has rendered service to an entity during a period, the entity shall recognize the contribution payable to a defined contribution plan in exchange for that service:**

    (a) **As a liability (accrued expense), after deducting any contribution already paid. If the contribution already paid exceeds the contribution due for service before the reporting date, an entity shall recognize that excess as an asset (prepaid expense) to the extent that the prepayment will lead to, for example, a reduction in future payments or a cash refund; and**

    (b) **As an expense, unless another Standard requires or permits the inclusion of the contribution in the cost of an asset (see, for example, IPSAS 12, "Inventories" and IPSAS 17, "Property, Plant and Equipment").**

56. **Where contributions to a defined contribution plan do not fall due wholly within twelve months after the end of the period in which the employees render the related service, they shall be discounted using the discount rate specified in paragraph 91.**

Disclosure

57. **An entity shall disclose the amount recognized as an expense for defined contribution plans.**

58. Where required by IPSAS 20 an entity discloses information about contributions to defined contribution plans for key management personnel.

Postemployment Benefits—Defined Benefit Plans

59. Accounting for defined benefit plans is complex because actuarial assumptions are required to measure the obligation and the expense and there is a possibility of actuarial gains and losses. Moreover, the obligations are measured on a discounted basis because they may be settled many years after the employees render the related service.

Recognition and Measurement

60. Defined benefit plans may be unfunded, or they may be wholly or partly funded by contributions by an entity, and sometimes its employees, into an entity, or fund, that is legally separate from the reporting entity and from which the employee benefits are paid. The payment of funded benefits when they fall due depends not only on the financial position and the investment performance of the fund but also on an entity's ability (and willingness) to make good any shortfall in the fund's assets. Therefore, the entity is, in substance, underwriting the actuarial and investment risks associated with the plan. Consequently, the expense recognized for a defined benefit plan is not necessarily the amount of the contribution due for the period.

61. Accounting by an entity for defined benefit plans involves the following steps:

    (a) Using actuarial techniques to make a reliable estimate of the amount of benefit that employees have earned in return for their service in the current and prior periods. This requires an entity to determine how much benefit is attributable to the current and prior periods (see paragraphs 80-84) and to make estimates (actuarial assumptions) about demographic variables (such as employee turnover and mortality) and financial variables (such as future increases in salaries and medical costs) that will influence the cost of the benefit (see paragraphs 85–104);

    (b) Discounting that benefit using the Projected Unit Credit Method in order to determine the present value of the defined benefit obligation and the current service cost (see paragraphs 77–79);

    (c) Determining the fair value of any plan assets (see paragraphs 118–120);

    (d) Determining the total amount of actuarial gains and losses and the amount of those actuarial gains and losses to be recognized (see paragraphs 105–111);

    (e) Where a plan has been introduced or changed, determining the resulting past service cost (see paragraphs 112–117); and

    (f) Where a plan has been curtailed or settled, determining the resulting gain or loss (see paragraphs 129–135).

    Where an entity has more than one defined benefit plan, the entity applies these procedures for each material plan separately. For example, a State Government responsible for educational and health services and a number of other services may have separate plans for teachers, healthcare workers and other employees.

62. In some cases, estimates, averages and computational short cuts may provide a reliable approximation of the detailed computations illustrated in this Standard.

Accounting for the Constructive Obligation

63. **An entity shall account not only for its legal obligation under the formal terms of a defined benefit plan, but also for any constructive obligation that arises from the entity's informal practices. Informal practices give rise to a constructive obligation where the entity has no realistic alternative but to pay employee benefits. An example of a constructive obligation is where a change in the entity's informal practices would cause unacceptable damage to its relationship with employees.**

64. The formal terms of a defined benefit plan may permit an entity to terminate its obligation under the plan. Nevertheless, it is usually difficult for an entity to cancel a plan if employees are to be retained. Therefore, in the absence of evidence to the contrary, accounting for postemployment benefits assumes that an entity which is currently promising such benefits will continue to do so over the remaining working lives of employees.

Statement of Financial Position

65. **The amount recognized as a defined benefit liability shall be the net total of the following amounts:**

    (a) **The present value of the defined benefit obligation at the reporting date (see paragraph 77);**

    (b) **Plus any actuarial gains (less any actuarial losses) not recognized because of the treatment set out in paragraphs 105 and 106;**

    (c) **Minus any past service cost not yet recognized (see paragraph 112); and**

    (d) **Minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 118–120).**

66. The present value of the defined benefit obligation is the gross obligation, before deducting the fair value of any plan assets.

67. **An entity shall determine the present value of defined benefit obligations and the fair value of any plan assets with sufficient regularity that the amounts recognized in the financial statements do not differ materially from the amounts that would be determined at the reporting date.**

68. This Standard encourages, but does not require, an entity to involve a qualified actuary in the measurement of all material postemployment benefit obligations. For practical reasons, an entity may request a qualified actuary to carry out a detailed valuation of the obligation before the reporting date. Nevertheless, the results of that valuation are updated for any material transactions and other material changes in circumstances (including changes in market prices and interest rates) up to the reporting date.

69. **The amount determined under paragraph 65 may be negative (an asset). An entity shall measure the resulting asset at the lower of:**

    (a) **The amount determined under paragraph 65; and**

    (b) **The total of:**

        (i) **Any cumulative unrecognized net actuarial losses and past service cost (see paragraphs 105, 106 and 112); and**

        (ii) **The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits shall be determined using the discount rate specified in paragraph 91.**

70. **The application of paragraph 69 shall not result in a gain being recognized solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognized solely as a result of an actuarial gain in the current period. The entity shall therefore recognize immediately under paragraph 65 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 69(b):**

    (a) **Net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 69(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period shall be recognized immediately under paragraph 65.**

    (b) **Net actuarial gains of the current period after the deduction of past service cost of the current period to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 69(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period shall be recognized immediately under paragraph 65.**

71. Paragraph 70 applies to an entity only if it has, at the beginning or end of the accounting period, a surplus[1] in a defined benefit plan and cannot, based on the current terms of the plan, recover that surplus fully through refunds or reductions in future contributions. In such cases, past service cost and actuarial losses that arise in the period, the recognition of which is deferred under

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[1] A surplus is an excess of the fair value of the plan assets over the present value of the defined benefit obligation.

paragraph 65, will increase the amount specified in paragraph 69(b)(i). If that increase is not offset by an equal decrease in the present value of economic benefits that qualify for recognition under paragraph 69(b)(ii), there will be an increase in the net total specified by paragraph 69(b) and, hence, a recognized gain. Paragraph 70 prohibits the recognition of a gain in these circumstances. The opposite effect arises with actuarial gains that arise in the period, the recognition of which is deferred under paragraph 65, to the extent that the actuarial gains reduce cumulative unrecognized actuarial losses. Paragraph 70 prohibits the recognition of a loss in these circumstances. [For examples of the application of this paragraph, see Implementation Guidance C.]

72. An asset may arise where a defined benefit plan has been overfunded or in certain cases where actuarial gains are recognized. An entity recognizes an asset in such cases because:

(a) The entity controls a resource, which is the ability to use the surplus to generate future benefits;

(b) That control is a result of past events (contributions paid by the entity and service rendered by the employee); and

(c) Future economic benefits are available to the entity in the form of a reduction in future contributions or a cash refund, either directly to the entity or indirectly to another plan in deficit.

73. The limit in paragraph 69(b) does not override the delayed recognition of certain actuarial losses (see paragraphs 105 and 106) and certain past service cost (see paragraph 112), other than as specified in paragraph 70. Paragraph 141(f)(iii) requires an entity to disclose any amount not recognized as an asset because of the limit in paragraph 69(b).

Statement of Financial Performance

74. **An entity shall recognize the net total of the following amounts in surplus or deficit, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:**

(a) **Current service cost (see paragraphs 76–104);**

(b) **Interest cost (see paragraph 95);**

(c) **The expected return on any plan assets (see paragraphs 125–127) and on any reimbursement rights (see paragraph 121);**

(d) **Actuarial gains and losses, as required in accordance with the entity's accounting policy (see paragraphs 105–109);**

(e) **Past service cost (see paragraph 112);**

(f) **The effect of any curtailments or settlements (see paragraphs 129 and 130); and**

(g) **The effect of the limit in paragraph 69(b), unless it is recognized in the Statement of Changes in Net Assets/Equity in accordance with paragraph 108.**

75. Other Standards require the inclusion of certain employee benefit costs within the cost of assets such as inventories or property, plant and equipment (see IPSAS 12 and IPSAS 17. Any postemployment benefit costs included in the cost of such assets include the appropriate proportion of the components listed in paragraph 74.

Recognition and Measurement: Present Value of Defined Benefit Obligations and Current Service Cost

76. The ultimate cost of a defined benefit plan may be influenced by many variables, such as final salaries, employee turnover and mortality, medical cost trends and, for a funded plan, the investment earnings on the plan assets. The ultimate cost of the plan is uncertain and this uncertainty is likely to persist over a long period of time. In order to measure the present value of the postemployment benefit obligations and the related current service cost, it is necessary to:

(a) Apply an actuarial valuation method (see paragraphs 77–79);

(b) Attribute benefit to periods of service (see paragraphs 80–84); and

(c) Make actuarial assumptions (see paragraphs 85–104).

Actuarial Valuation Method

77. **An entity shall use the Projected Unit Credit Method to determine the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost.**

78. The Projected Unit Credit Method (sometimes known as the accrued benefit method pro rated on service or as the benefit/years of service method) sees each period of service as giving rise to an additional unit of benefit entitlement (see paragraphs 80–84) and measures each unit separately to build up the final obligation (see paragraphs 85–104.)

79. An entity discounts the whole of a postemployment benefit obligation, even if part of the obligation falls due within twelve months of the reporting date.

Attributing Benefit to Periods of Service

80. **In determining the present value of its defined benefit obligations and the related current service cost and, where applicable, past service cost, an entity shall attribute benefit to periods of service under the plan's benefit formula. However, if an employee's service in later years will lead to a materially higher level of benefit than in earlier years, an entity shall attribute benefit on a straight-line basis from:**

(a) **The date when service by the employee first leads to benefits under the plan (whether or not the benefits are conditional on further service); until**

(b) **The date when further service by the employee will lead to no material amount of further benefits under the plan, other than from further salary increases.**

81. The Projected Unit Credit Method requires an entity to attribute benefit to the current period (in order to determine current service cost) and the current and prior periods (in order to determine the present value of defined benefit obligations). An entity attributes benefit to periods in which the obligation to provide postemployment benefits arises. That obligation arises as employees render services in return for postemployment benefits which an entity expects to pay in future reporting periods. Actuarial techniques allow an entity to measure that obligation with sufficient reliability to justify recognition of a liability.

82. Employee service gives rise to an obligation under a defined benefit plan even if the benefits are conditional on future employment (in other words, they are not vested). Employee service before the vesting date gives rise to a constructive obligation because, at each successive reporting date, the amount of future service that an employee will have to render before becoming entitled to the benefit is reduced. In measuring its defined benefit obligation, an entity considers the probability that some employees may not satisfy any vesting requirements. Similarly, although certain postemployment benefits, for example, postemployment medical benefits, become payable only if a specified event occurs when an employee is no longer employed, an obligation is created when the employee renders service that will provide entitlement to the benefit if the specified event occurs. The probability that the specified event will occur affects the measurement of the obligation, but does not determine whether the obligation exists.

83. The obligation increases until the date when further service by the employee will lead to no material amount of further benefits. Therefore, all benefit is attributed to periods ending on or before that date. Benefit is attributed to individual accounting periods under the plan’s benefit formula. However, if an employee’s service in later years will lead to a materially higher level of benefit than in earlier years, an entity attributes benefit on a straight-line basis until the date when further service by the employee will lead to no material amount of further benefits. That is because the employee’s service throughout the entire period will ultimately lead to benefit at that higher level.

84. Where the amount of a benefit is a constant proportion of final salary for each year of service, future salary increases will affect the amount required to settle the obligation that exists for service before the reporting date, but do not create an additional obligation. Therefore:

(a) For the purpose of paragraph 80(b), salary increases do not lead to further benefits, even though the amount of the benefits is dependent on final salary; and

(b) The amount of benefit attributed to each period is a constant proportion of the salary to which the benefit is linked.

Actuarial Assumptions

85. **Actuarial assumptions shall be unbiased and mutually compatible.**

86. Actuarial assumptions are an entity's best estimates of the variables that will determine the ultimate cost of providing postemployment benefits. Actuarial assumptions comprise:

(a) Demographic assumptions about the future characteristics of current and former employees (and their dependants) who are eligible for benefits. Demographic assumptions deal with matters such as:

(i) Mortality, both during and after employment;

(ii) Rates of employee turnover, disability and early retirement;

(iii) The proportion of plan members with dependants who will be eligible for benefits; and

(iv) Claim rates under medical plans.

(b) Financial assumptions, dealing with items such as:

(i) The discount rate (see paragraphs 91–95);

(ii) Future salary and benefit levels (see paragraphs 96–100);

(iii) In the case of medical benefits, future medical costs, including, where material, the cost of administering claims and benefit payments (see paragraphs 101–104); and

(iv) The expected rate of return on plan assets (see paragraphs 125–127).

87. Actuarial assumptions are unbiased if they are neither imprudent nor excessively conservative.

88. Actuarial assumptions are mutually compatible if they reflect the economic relationships between factors such as inflation, rates of salary increase, the return on plan assets and discount rates. For example, all assumptions which depend on a particular inflation level (such as assumptions about interest rates and salary and benefit increases) in any given future period assume the same inflation level in that period.

89. An entity determines the discount rate and other financial assumptions in nominal (stated) terms, unless estimates in real (inflation-adjusted) terms are

more reliable, for example, in a hyper-inflationary economy (see IPSAS 10, "Financial Reporting in Hyperinflationary Economies"), or where the benefit is index-linked and there is a deep market in index-linked bonds of the same currency and term.

90. **Financial assumptions shall be based on market expectations, at the reporting date, for the period over which the obligations are to be settled.**

Actuarial Assumptions—Discount Rate

91. **The rate used to discount postemployment benefit obligations (both funded and unfunded) shall reflect the time value of money. The currency and term of the financial instrument selected to reflect the time value of money shall be consistent with the currency and estimated term of the postemployment benefit obligations.**

92. One actuarial assumption which has a material effect is the discount rate. The discount rate reflects the time value of money but not the actuarial or investment risk. Furthermore, the discount rate does not reflect the entity-specific credit risk borne by the entity's creditors, nor does it reflect the risk that future experience may differ from actuarial assumptions.

93. The discount rate reflects the estimated timing of benefit payments. In practice, an entity often achieves this by applying a single weighted average discount rate that reflects the estimated timing and amount of benefit payments and the currency in which the benefits are to be paid.

94. An entity makes a judgment whether the discount rate that reflects the time value of money is best approximated by reference to market yields at the reporting date on government bonds, high quality corporate bonds or by another financial instrument. In some jurisdictions, market yields at the reporting date on government bonds will provide the best approximation of the time value of money. However, there may be jurisdictions in which this is not the case, for example, jurisdictions where there is no deep market in government bonds, or in which market yields at the reporting date on government bonds do not reflect the time value of money. In such cases, the reporting entity determines the rate by another method, such as by reference to market yields on high quality corporate bonds. There may also be circumstances where there is no deep market in government bonds or high quality corporate bonds with a sufficiently long maturity to match the estimated maturity of all the benefit payments. In such circumstances, an entity uses current market rates of the appropriate term to discount shorter term payments, and estimates the discount rate for longer maturities by extrapolating current market rates along the yield curve. The total present value of a defined benefit obligation is unlikely to be particularly sensitive to the discount rate applied to the portion of benefits that is payable beyond the final maturity of the available financial instrument, such as government bonds or corporate bonds.

95. Interest cost is computed by multiplying the discount rate as determined at the start of the period by the present value of the defined benefit obligation throughout that period, taking account of any material changes in the obligation. The present value of the obligation will differ from the liability recognized in the statement of financial position because the liability is recognized after deducting the fair value of any plan assets and because some actuarial gains and losses, and some past service cost, are not recognized immediately. [Implementation Guidance A illustrates the computation of interest cost, among other things.]

Actuarial Assumptions—Salaries, Benefits and Medical Costs

96. **Postemployment benefit obligations shall be measured on a basis that reflects:**

    (a) **Estimated future salary increases;**

    (b) **The benefits set out in the terms of the plan (or resulting from any constructive obligation that goes beyond those terms) at the reporting date; and**

    (c) **Estimated future changes in the level of any state benefits that affect the benefits payable under a defined benefit plan, if, and only if, either:**

        (i) **Those changes were enacted before the reporting date; or**

        (ii) **Past history, or other reliable evidence, indicates that those state benefits will change in some predictable manner, for example, in line with future changes in general price levels or general salary levels.**

97. Estimates of future salary increases take account of inflation, seniority, promotion and other relevant factors, such as supply and demand in the employment market.

98. If the formal terms of a plan (or a constructive obligation that goes beyond those terms) require an entity to change benefits in future periods, the measurement of the obligation reflects those changes. This is the case when, for example:

    (a) The entity has a past history of increasing benefits, for example, to mitigate the effects of inflation, and there is no indication that this practice will change in the future; or

    (b) Actuarial gains have already been recognized in the financial statements and the entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants (see paragraph 114(c)).

99. Actuarial assumptions do not reflect future benefit changes that are not set out in the formal terms of the plan (or a constructive obligation) at the reporting date. Such changes will result in:

    (a) Past service cost, to the extent that they change benefits for service before the change; and

    (b) Current service cost for periods after the change, to the extent that they change benefits for service after the change.

100. Some postemployment benefits are linked to variables such as the level of benefit entitlements from social security pensions or state medical care. The measurement of such benefits reflects expected changes in such variables, based on past history and other reliable evidence.

101. **Assumptions about medical costs shall take account of estimated future changes in the cost of medical services, resulting from both inflation and specific changes in medical costs.**

102. Measurement of postemployment medical benefits requires assumptions about the level and frequency of future claims and the cost of meeting those claims. An entity estimates future medical costs on the basis of historical data about the entity's own experience, supplemented where necessary by historical data from other entities, insurance companies, medical providers or other sources. Estimates of future medical costs consider the effect of technological advances, changes in health care utilisation or delivery patterns and changes in the health status of plan participants.

103. The level and frequency of claims is particularly sensitive to the age, health status and gender of employees (and their dependants) and may be sensitive to other factors such as geographical location. Therefore, historical data is adjusted to the extent that the demographic mix of the population differs from that of the population used as a basis for the historical data. It is also adjusted where there is reliable evidence that historical trends will not continue.

104. Some postemployment health care plans require employees to contribute to the medical costs covered by the plan. Estimates of future medical costs take account of any such contributions, based on the terms of the plan at the reporting date (or based on any constructive obligation that goes beyond those terms.) Changes in those employee contributions result in past service cost or, where applicable, curtailments. The cost of meeting claims may be reduced by benefits from state or other medical providers (see paragraphs 96(c) and 100.)

Actuarial Gains and Losses

105. **In measuring its defined benefit liability in accordance with paragraph 65, an entity shall, subject to paragraph 70, recognize a portion (as specified in paragraph 106) of its actuarial gains and losses as revenue or**

expense if the net cumulative unrecognized actuarial gains and losses at the end of the previous reporting period exceeded the greater of:

(a) **10% of the present value of the defined benefit obligation at that date (before deducting plan assets); and**

(b) **10% of the fair value of any plan assets at that date.**

These limits shall be calculated and applied separately for each defined benefit plan.

106. **The portion of actuarial gains and losses to be recognized for each defined benefit plan is the excess determined in accordance with paragraph 105, divided by the expected average remaining working lives of the employees participating in that plan. However, an entity may adopt any systematic method that results in faster recognition of actuarial gains and losses, provided that the same basis is applied to both gains and losses and the basis is applied consistently from period to period. An entity may apply such systematic methods to actuarial gains and losses even if they are within the limits specified in paragraph 105.**

107. **If, as permitted by paragraph 106, an entity adopts a policy of recognizing actuarial gains and losses in the period in which they occur, it may recognize them as a separate item directly in net assets/equity, in accordance with paragraphs 108 and 109, providing it does so for:**

(a) All of its defined benefit plans; and

(b) All of its actuarial gains and losses.

108. Actuarial gains and losses recognized directly in net assets/equity as permitted by paragraph 107 shall be presented in the statement of changes in net assets/equity in accordance with paragraph 118(b) of IPSAS 1.

109. An entity that recognizes actuarial gains and losses in accordance with paragraph 107 shall also recognize any adjustments arising from the limit in paragraph 69(b) outside surplus or deficit in the statement of changes in net assets/equity in accordance with paragraph 118(b) of IPSAS 1. Actuarial gains and losses and adjustments arising from the limit in paragraph 69(b) that have been recognized directly in the statement of changes in net assets/equity shall be recognized immediately in accumulated surpluses or deficits. They shall not be recognized in surplus or deficit in a subsequent period.

110. Actuarial gains and losses may result from increases or decreases in either the present value of a defined benefit obligation or the fair value of any related plan assets. Causes of actuarial gains and losses include, for example:

(a) Unexpectedly high or low rates of employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;

(b) The effect of changes in estimates of future employee turnover, early retirement or mortality or of increases in salaries, benefits (if the formal or constructive terms of a plan provide for inflationary benefit increases) or medical costs;

(c) The effect of changes in the discount rate; and

(d) Differences between the actual return on plan assets and the expected return on plan assets (see paragraphs 125–127).

111. In the long term, actuarial gains and losses may offset one another. Therefore, estimates of postemployment benefit obligations may be viewed as a range (or corridor) around the best estimate. An entity is permitted, but not required, to recognize actuarial gains and losses that fall within that range. This Standard requires an entity to recognize, as a minimum, a specified portion of the actuarial gains and losses that fall outside a corridor of plus or minus 10%. [Implementation Guidance A illustrates the treatment of actuarial gains and losses, among other things.] The Standard also permits systematic methods of faster recognition, provided that those methods satisfy the conditions set out in paragraph 106. Such permitted methods include, for example, immediate recognition of all actuarial gains and losses, both within and outside the corridor.

Past Service Cost

112. **In measuring its defined benefit liability under paragraph 65, an entity shall, subject to paragraph 70, recognize past service cost as an expense on a straight-line basis over the average period until the benefits become vested. To the extent that the benefits are already vested immediately following the introduction of, or changes to, a defined benefit plan, an entity shall recognize past service cost immediately.**

113. Past service cost arises when an entity introduces a defined benefit plan or changes the benefits payable under an existing defined benefit plan. Such changes are in return for employee service over the period until the benefits concerned are vested. Therefore, past service cost is recognized over that period, regardless of the fact that the cost refers to employee service in previous periods. Past service cost is measured as the change in the liability resulting from the amendment (see paragraph 77).

114. Past service cost excludes:

(a) The effect of differences between actual and previously assumed salary increases on the obligation to pay benefits for service in prior years (there is no past service cost because actuarial assumptions allow for projected salaries);

(b) Under and over estimates of discretionary pension increases where an entity has a constructive obligation to grant such increases (there is no past service cost because actuarial assumptions allow for such increases);

(c) Estimates of benefit improvements that result from actuarial gains that have already been recognized in the financial statements if the entity is obliged, by either the formal terms of a plan (or a constructive obligation that goes beyond those terms) or legislation, to use any surplus in the plan for the benefit of plan participants, even if the benefit increase has not yet been formally awarded (the resulting increase in the obligation is an actuarial loss and not past service cost, see paragraph 98(b));

(d) The increase in vested benefits when, in the absence of new or improved benefits, employees complete vesting requirements (there is no past service cost because the estimated cost of benefits was recognized as current service cost as the service was rendered); and

(e) The effect of plan amendments that reduce benefits for future service (a curtailment).

115. An entity establishes the amortization schedule for past service cost when the benefits are introduced or changed. It would be impracticable to maintain the detailed records needed to identify and implement subsequent changes in that amortization schedule. Moreover, the effect is likely to be material only where there is a curtailment or settlement. Therefore, an entity amends the amortization schedule for past service cost only if there is a curtailment or settlement.

116. Where an entity reduces benefits payable under an existing defined benefit plan, the resulting reduction in the defined benefit liability is recognized as (negative) past service cost over the average period until the reduced portion of the benefits becomes vested.

117. Where an entity reduces certain benefits payable under an existing defined benefit plan and, at the same time, increases other benefits payable under the plan for the same employees, the entity treats the change as a single net change.

Recognition and Measurement: Plan Assets

Fair Value of Plan Assets

118. The fair value of any plan assets is deducted in determining the amount recognized in the statement of financial position under paragraph 65. When no market price is available, the fair value of plan assets is estimated; for example, by discounting expected future cash flows using a discount rate that reflects both the risk associated with the plan assets and the maturity or expected disposal date of those assets (or, if they have no maturity, the expected period until the settlement of the related obligation).

119. Plan assets exclude unpaid contributions due from the reporting entity to the fund, as well as any non-transferable financial instruments issued by the entity and held by the fund. Plan assets are reduced by any liabilities of the fund that do not relate to employee benefits, for example, trade and other payables and liabilities resulting from derivative financial instruments.

120. Where plan assets include qualifying insurance policies that exactly match the amount and timing of some or all of the benefits payable under the plan, the fair value of those insurance policies is deemed to be the present value of the related obligations, as described in paragraph 65 (subject to any reduction required if the amounts receivable under the insurance policies are not recoverable in full).

Reimbursements

121. **When, and only when, it is virtually certain that another party will reimburse some or all of the expenditure required to settle a defined benefit obligation, an entity shall recognize its right to reimbursement as a separate asset. The entity shall measure the asset at fair value. In all other respects, an entity shall treat that asset in the same way as plan assets. In the statement of financial performance, the expense relating to a defined benefit plan may be presented net of the amount recognized for a reimbursement.**

122. Sometimes, an entity is able to look to another party, such as an insurer, to pay part or all of the expenditure required to settle a defined benefit obligation. Qualifying insurance policies, as defined in paragraph 10, are plan assets. An entity accounts for qualifying insurance policies in the same way as for all other plan assets and paragraph 121 does not apply (see paragraphs 50–53 and 120).

123 When an insurance policy is not a qualifying insurance policy, that insurance policy is not a plan asset. Paragraph 121 deals with such cases: the entity recognizes its right to reimbursement under the insurance policy as a separate asset, rather than as a deduction in determining the defined benefit liability recognized under paragraph 65; in all other respects, the entity treats that asset in the same way as plan assets. In particular, the defined benefit liability recognized under paragraph 65 is increased (reduced) to the extent that net cumulative actuarial gains (losses) on the defined benefit obligation and on the related reimbursement right remain unrecognized under paragraphs 105 and 106. Paragraph 141(f)(iv) requires the entity to disclose a brief description of the link between the reimbursement right and the related obligation.

124. If the right to reimbursement arises under an insurance policy or a legally binding agreement that exactly matches the amount and timing of some or all of the benefits payable under a defined benefit plan, the fair value of the reimbursement right is deemed to be the present value of the related obligation,

as described in paragraph 65 (subject to any reduction required if the reimbursement is not recoverable in full).

Return on Plan Assets

125. The expected return on plan assets is one component of the expense recognized in the statement of financial performance. The difference between the expected return on plan assets and the actual return on plan assets is an actuarial gain or loss; it is included with the actuarial gains and losses on the defined benefit obligation in determining the net amount that is compared with the limits of the 10% corridor specified in paragraph 105.

126. The expected return on plan assets is based on market expectations, at the beginning of the period, for returns over the entire life of the related obligation. The expected return on plan assets reflects changes in the fair value of plan assets held during the period as a result of actual contributions paid into the fund and actual benefits paid out of the fund.

127. In determining the expected and actual return on plan assets, an entity deducts expected administration costs, other than those included in the actuarial assumptions used to measure the obligation.

Entity Combinations

128. In determining the assets and liabilities to be recognized related to postemployment benefits in an entity combination, an entity considers the international or national accounting standard dealing with entity combinations.

Curtailments and Settlements

129. **An entity shall recognize gains or losses on the curtailment or settlement of a defined benefit plan when the curtailment or settlement occurs. The gain or loss on a curtailment or settlement shall comprise:**

(a) **Any resulting change in the present value of the defined benefit obligation;**

(b) **Any resulting change in the fair value of the plan assets; and**

(c) **Any related actuarial gains and losses and past service cost that, under paragraphs 105 and 112, had not previously been recognized.**

130. **Before determining the effect of a curtailment or settlement, an entity shall remeasure the obligation (and the related plan assets, if any) using current actuarial assumptions (including current market interest rates and other current market prices).**

131. A curtailment occurs when an entity either:

(a) Is demonstrably committed to make a material reduction in the number of employees covered by a plan; or

(b) Amends the terms of a defined benefit plan such that a material element of future service by current employees will no longer qualify for benefits, or will qualify only for reduced benefits.

A curtailment may arise from an isolated event, such as the closing of a plant, discontinuance of an operation or termination or suspension of a plan. An event is material enough to qualify as a curtailment if the recognition of a curtailment gain or loss would have a material effect on the financial statements. Curtailments are often linked with a restructuring. Therefore, an entity accounts for a curtailment at the same time as for a related restructuring.

132. A settlement occurs when an entity enters into a transaction that eliminates all further legal or constructive obligation for part or all of the benefits provided under a defined benefit plan, for example, when a lump-sum cash payment is made to, or on behalf of, plan participants in exchange for their rights to receive specified postemployment benefits.

133. In some cases, an entity acquires an insurance policy to fund some or all of the employee benefits relating to employee service in the current and prior periods. The acquisition of such a policy is not a settlement if the entity retains a legal or constructive obligation (see paragraph 50) to pay further amounts if the insurer does not pay the employee benefits specified in the insurance policy. Paragraphs 121–124 deal with the recognition and measurement of reimbursement rights under insurance policies that are not plan assets.

134. A settlement occurs together with a curtailment if a plan is terminated such that the obligation is settled and the plan ceases to exist. However, the termination of a plan is not a curtailment or settlement if the plan is replaced by a new plan that offers benefits that are, in substance, identical.

135. Where a curtailment relates to only some of the employees covered by a plan, or where only part of an obligation is settled, the gain or loss includes a proportionate share of the previously unrecognized past service cost and actuarial gains and losses. The proportionate share is determined on the basis of the present value of the obligations before and after the curtailment or settlement, unless another basis is more rational in the circumstances. For example, it may be appropriate to apply any gain arising on a curtailment or settlement of the same plan to first eliminate any unrecognized past service cost relating to the same plan.

Presentation

Offset

136. **An entity shall offset an asset relating to one plan against a liability relating to another plan when, and only when, the entity:**

(a) **Has a legally enforceable right to use a surplus in one plan to settle obligations under the other plan; and**

(b) **Intends either to settle the obligations on a net basis, or to realise the surplus in one plan and settle its obligation under the other plan simultaneously.**

137. The offsetting criteria are similar to those established for financial instruments in IPSAS 15, "Financial Instruments: Disclosure and Presentation."

Current/Non-Current Distinction

138. Some entities distinguish current assets and liabilities from non-current assets and liabilities. This Standard does not specify whether an entity should distinguish current and non-current portions of assets and liabilities arising from postemployment benefits.

Financial Components of Postemployment Benefit Costs

139. This Standard does not specify whether an entity should present current service cost, interest cost and the expected return on plan assets as components of a single item of revenue or expense on the face of the statement of financial performance.

Disclosure

140. **An entity shall disclose information that enables users of financial statements to evaluate the nature of its defined benefit plans and the financial effects of changes in those plans during the period.**

141. **An entity shall disclose the following information about defined benefit plans:**

(a) **The entity's accounting policy for recognizing actuarial gains and losses;**

(b) **A general description of the type of plan;**

(c) **A reconciliation of opening and closing balances of the present value of the defined benefit obligation showing separately, if applicable, the effects during the period attributable to each of the following:**

(i) **Current service cost;**

(ii) **Interest cost;**

(iii) **Contributions by plan participants;**

(iv) **Actuarial gains and losses;**

(v) **Foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency;**

(vi) **Benefits paid;**

(vii) **Past service cost;**

(viii) **Entity combinations;**

(ix) **Curtailments; and**

(x) **Settlements.**

(d) **An analysis of the defined benefit obligation into amounts arising from plans that are wholly unfunded and amounts arising from plans that are wholly or partly funded;**

(e) **A reconciliation of the opening and closing balances of the fair value of plan assets and of the opening and closing balances of any reimbursement right recognized as an asset in accordance with paragraph 121 showing separately, if applicable, the effects during the period attributable to each of the following:**

(i) **Expected return on plan assets;**

(ii) **Actuarial gains and losses;**

(iii) **Foreign currency exchange rate changes on plans measured in a currency different from the entity's presentation currency;**

(iv) **Contributions by the employer;**

(v) **Contributions by plan participants;**

(vi) **Benefits paid;**

(vii) **Entity combinations; and**

(viii) **Settlements.**

(f) **A reconciliation of the present value of the defined benefit obligation in (c) and the fair value of the plan assets in (e) to the assets and liabilities recognized in the statement of financial position, showing at least:**

(i) **The net actuarial gains or losses not recognized in the statement of financial position (see paragraph 105);**

(ii) **The past service cost not recognized in the statement of financial position (see paragraph 112);**

(iii) **Any amount not recognized as an asset, because of the limit in paragraph 69(b);**

(iv) **The fair value at the reporting date of any reimbursement right recognized as an asset in accordance with paragraph 121 (with a brief description of the link between the reimbursement right and the related obligation); and**

(v) **The other amounts recognized in the statement of financial position.**

(g) **The total expense recognized in the statement of financial performance for each of the following, and the line item(s) in which they are included:**

(i) **Current service cost;**

(ii) **Interest cost;**

(iii) **Expected return on plan assets;**

(iv) **Expected return on any reimbursement right recognized as an asset in accordance with paragraph 121;**

(v) **Actuarial gains and losses;**

(vi) **Past service cost;**

(vii) **The effect of any curtailment or settlement; and**

(viii) **The effect of the limit in paragraph 69(b).**

(h) **The total amount recognized in the statement of changes in net assets/equity for each of the following:**

(i) **Actuarial gains and losses; and**

(ii) **The effect of the limit in paragraph 69(b).**

(i) **For entities that recognize actuarial gains and losses in the statement of changes in net assets/equity in accordance with paragraph 107, the cumulative amount of actuarial gains and losses recognized in that statement;**

(j) **For each major category of plan assets, which shall include, but is not limited to, equity instruments, debt instruments, property, and all other assets, the percentage or amount that each major category constitutes of the fair value of the total plan assets;**

(k) **The amounts included in the fair value of plan assets for:**

(i) Each category of the entity's own financial instruments; and

(ii) Any property occupied by, or other assets used by, the entity.

(l) **A narrative description of the basis used to determine the overall expected rate of return on assets, including the effect of the major categories of plan assets;**

(m) **The actual return on plan assets, as well as the actual return on any reimbursement right recognized as an asset in accordance with paragraph 121;**

(n) **The principal actuarial assumptions used as at the reporting date, including, when applicable:**

  (i) **The discount rates;**

  (ii) **The basis on which the discount rate has been determined;**

  (iii) **The expected rates of return on any plan assets for the periods presented in the financial statements;**

  (iv) **The expected rates of return for the periods presented in the financial statements on any reimbursement right recognized as an asset in accordance with paragraph 121;**

  (v) **The expected rates of salary increases (and of changes in an index or other variable specified in the formal or constructive terms of a plan as the basis for future benefit increases);**

  (vi) **Medical cost trend rates; and**

  (vii) **Any other material actuarial assumptions used.**

  An entity shall disclose each actuarial assumption in absolute terms (for example, as an absolute percentage) and not just as a margin between different percentages or other variables;

(o) **The effect of an increase of one percentage point and the effect of a decrease of one percentage point in the assumed medical cost trend rates on:**

  (i) **The aggregate of the current service cost and interest cost components of net periodic postemployment medical costs; and**

  (ii) **The accumulated postemployment benefit obligation for medical costs.**

  For the purposes of this disclosure, all other assumptions shall be held constant. For plans operating in a high inflation environment, the disclosure shall be the effect of a percentage increase or decrease in the assumed medical cost trend rate of a significance similar to one percentage point in a low inflation environment;

(p) **The amounts for the current annual period and previous four annual periods of:**

(i) **The present value of the defined benefit obligation, the fair value of the plan assets and the surplus or deficit in the plan; and**

(ii) **The experience adjustments arising on:**

– **The plan liabilities expressed either as (1) an amount or (2) a percentage of the plan liabilities at the reporting date; and**

– **The plan assets expressed either as (1) an amount or (2) a percentage of the plan assets at the reporting date.**

(q) **The employer's best estimate, as soon as it can reasonably be determined, of contributions expected to be paid to the plan during the annual period beginning after the reporting date.**

142. Paragraph 141(b) requires a general description of the type of plan. Such a description distinguishes, for example, flat salary pension plans from final salary pension plans and from postemployment medical plans. The description of the plan includes informal practices that give rise to constructive obligations included in the measurement of the defined benefit obligation in accordance with paragraph 63. Further detail is not required.

143. When an entity has more than one defined benefit plan, disclosures may be made in total, separately for each plan, or in such groupings as are considered to be the most useful. It may be useful to distinguish groupings by criteria such as the following:

(a) The geographical location of the plans; or

(b) Whether plans are subject to materially different risks, for example, by distinguishing flat salary pension plans from final salary pension plans and from postemployment medical plans.

When an entity provides disclosures in total for a grouping of plans, such disclosures are provided in the form of weighted averages or of relatively narrow ranges.

144. Paragraph 33 requires additional disclosures about multi-employer defined benefit plans that are treated as if they were defined contribution plans.

145. Where required by IPSAS 20 an entity discloses information about:

(a) Related party transactions with postemployment benefit plans; and

(b) Postemployment benefits for key management personnel.

146. Where required by IPSAS 19 an entity discloses information about contingent liabilities arising from postemployment benefit obligations.

Other Long-Term Employee Benefits

147. Other long-term employee benefits may include, for example:

(a) Long-term compensated absences such as long service or sabbatical leave;

(b) Jubilee or other long service benefits;

(c) Long-term disability benefits;

(d) Bonuses and profit-sharing payable twelve months or more after the end of the period in which the employees render the related service; and

(e) Deferred compensation paid twelve months or more after the end of the period in which it is earned.

(f) Compensation payable by the entity until an individual enters new employment.

148. The measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of postemployment benefits. Furthermore, the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost. For these reasons, this Standard requires a simplified method of accounting for other long-term employee benefits. This method differs from the accounting required for postemployment benefits as follows:

(a) Actuarial gains and losses are recognized immediately and no corridor is applied; and

(b) All past service cost is recognized immediately.

149. This Standard includes a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of postemployment benefits. Where this presumption is rebutted the entity considers whether some or all long-term disability payments should be accounted for in accordance with paragraphs 59–146.

Recognition and Measurement

150. **The amount recognized as a liability for other long-term employee benefits shall be the net total of the following amounts:**

(a) **The present value of the defined benefit obligation at the reporting date (see paragraph 77);**

(b) **Minus the fair value at the reporting date of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 118–120).**

In measuring the liability, an entity shall apply paragraphs 55–104, excluding paragraphs 65 and 74. An entity shall apply paragraph 121 in recognizing and measuring any reimbursement right.

151. **For other long-term employee benefits, an entity shall recognize the net total of the following amounts as expense or (subject to paragraph 69) revenue, except to the extent that another Standard requires or permits their inclusion in the cost of an asset:**

(a) **Current service cost (see paragraphs 76–104);**

(b) **Interest cost (see paragraph 95);**

(c) **The expected return on any plan assets (see paragraphs 125–127) and on any reimbursement right recognized as an asset (see paragraph 121);**

(d) **Actuarial gains and losses, which shall all be recognized immediately;**

(e) **Past service cost, which shall all be recognized immediately; and**

(f) **The effect of any curtailments or settlements (see paragraphs 129 and 130).**

152. One form of other long-term employee benefit is long-term disability benefit. If the level of benefit depends on the length of service, an obligation arises when the service is rendered. Measurement of that obligation reflects the probability that payment will be required and the length of time for which payment is expected to be made. If the level of benefit is the same for any disabled employee regardless of years of service, the expected cost of those benefits is recognized when an event occurs that causes a long-term disability. Paragraph 149 highlights the possibility that long-term disability benefit payments may be subject to a higher degree of uncertainty than other long-term employee benefits.

Disclosure

153. Although this Standard does not require specific disclosures about other long-term employee benefits, other Standards may require disclosures; for example, where the expense resulting from such benefits is material and so would require disclosure in accordance with IPSAS 1. When required by IPSAS 20 an entity discloses information about other long-term employee benefits for key management personnel.

Termination Benefits

154. This Standard deals with termination benefits separately from other employee benefits because the event which gives rise to an obligation is the termination rather than employee service.

Recognition

155. **An entity shall recognize termination benefits as a liability and an expense when, and only when, the entity is demonstrably committed to either:**

 (a) **Terminate the employment of an employee or group of employees before the normal retirement date; or**

 (b) **Provide termination benefits as a result of an offer made in order to encourage voluntary redundancy.**

156. **An entity is demonstrably committed to a termination when, and only when, the entity has a detailed formal plan for the termination and is without realistic possibility of withdrawal. The detailed plan shall include, as a minimum:**

 (a) **The location, function, and approximate number of employees whose services are to be terminated;**

 (b) **The termination benefits for each job classification or function; and**

 (c) **The time at which the plan will be implemented. Implementation shall begin as soon as possible and the period of time to complete implementation shall be such that material changes to the plan are not likely.**

157. An entity may be committed, 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. Termination benefits are typically lump-sum payments, but sometimes also include:

 (a) Enhancement of retirement benefits or of other postemployment benefits, either indirectly through an employee benefit plan or directly; and

 (b) Salary until the end of a specified notice period if the employee renders no further service that provides economic benefits to the entity.

158. Some employee benefits are payable regardless of the reason for the employee's departure. The payment of such benefits is certain (subject to any vesting or minimum service requirements) but the timing of their payment is uncertain. Although such benefits are described in some countries as termination

indemnities, or termination gratuities, they are postemployment benefits, rather than termination benefits and an entity accounts for them as postemployment benefits. Some entities provide a lower level of benefit for voluntary termination at the request of the employee (in substance, a postemployment benefit) than for involuntary termination at the request of the entity. The additional benefit payable on involuntary termination is a termination benefit.

159. Termination benefits do not provide an entity with future economic benefits and are recognized as an expense immediately.

160. Where an entity recognizes termination benefits, the entity may also have to account for a curtailment of retirement benefits or other employee benefits (see paragraph 129).

Measurement

161. **Where termination benefits fall due more than 12 months after the reporting date, they shall be discounted using the discount rate specified in paragraph 91.**

162. **In the case of an offer made to encourage voluntary redundancy, the measurement of termination benefits shall be based on the number of employees expected to accept the offer.**

Disclosure

163. Where there is uncertainty about the number of employees who will accept an offer of termination benefits, a contingent liability exists. As required by IPSAS 19, an entity discloses information about the contingent liability unless the possibility of an outflow in settlement is remote.

164. As required by IPSAS 1, an entity discloses the nature and amount of an expense if it is material. Termination benefits may result in an expense needing disclosure in order to comply with this requirement.

165. Where required by IPSAS 20 an entity discloses information about termination benefits for key management personnel.

First Time Adoption of this Standard

166. **On first adopting this Standard, an entity shall determine its initial liability for defined benefit plans at that date as:**

    (a) **The present value of the obligations (see paragraph 77) at the date of adoption;**

    (b) **Minus the fair value, at the date of adoption, of plan assets (if any) out of which the obligations are to be settled directly (see paragraphs 118–120);**

(c) **Minus any past service cost that, under paragraph 112, shall be recognized in later periods.**

167. **If the initial liability determined in accordance with paragraph 166 is more or less than the liability that would have been recognized at the same date under the entity's previous accounting policy, the entity shall recognize that increase/decrease in opening accumulated surpluses or deficits.**

168. On the initial adoption of this Standard, the effect of the change in accounting policy includes all actuarial gains and losses that arose in earlier periods even if they fall inside the corridor specified in paragraph 105. Entities reporting under accrual accounting for the first time will not have recognized any liability, in which case the increase in the liability will represent the full amount of the liability minus the fair value, at the date of adoption, of any plan assets in accordance with paragraph 166(b) and any past service cost to be recognized in later periods in accordance with paragraph 166(c). Under the provisions of this Standard, this increased liability is recognized in accumulated surpluses or deficits.

169. **On first adopting this Standard an entity shall not split the cumulative actuarial gains and losses from the inception of the defined benefit plan(s) until the date of first adoption of this Standard into a recognized and unrecognized portion. All cumulative actuarial gains and losses shall be recognized in opening accumulated surpluses or deficits.**

170. On first adoption of this Standard, entities are not permitted to split cumulative actuarial gains and losses into recognized and unrecognized portions. All cumulative gains and losses are recognized in opening accumulated surpluses or deficits. This requirement on first time adoption of this Standard does not preclude an entity electing to recognize only part of its actuarial gains and losses in accordance with the requirements in paragraphs 105–107 in subsequent reporting periods.

171. **In the first year of adoption of this Standard an entity is not required to provide comparative information.**

172. Paragraph 171 provides relief from the inclusion of comparative information to all entities in the first year of adoption of this Standard. An entity is encouraged to include comparative information where this is available.

173. **In the first year of adoption of this Standard, an entity is not required to provide the disclosures in paragraphs 141(c), 141(e) and 141(f).**

174. The reconciliations in paragraphs 141(c) and 141(e) both involve the disclosure of opening balances relating to components of defined benefit obligations, plan assets and reimbursement rights. The disclosure in paragraph 141(f) requires a reconciliation which relies on information in paragraphs 141(c) and 141(e). These disclosures are not required in the first year of

adoption of this Standard. An entity is encouraged to include these disclosures where the information is available.

175. **In the first year of adoption of this Standard, an entity may provide the information required in paragraph 141(p) prospectively.**

176. The information specified in paragraph 141(p) relates to the present value of the defined benefit obligation, the fair value of the plan assets, the surplus or deficit in the plan and certain experience adjustments. This disclosure is only required for the current annual period in the first year of adoption. Information on prior annual periods can be provided prospectively as the entity reports under the requirements of this Standard. This allows entities to build trend information over a period, rather than producing such information for reporting periods prior to the period of first adoption of the Standard.

Effective Date

177. **This Standard becomes effective for annual financial statements covering periods beginning on or after January 1, 2011. Earlier adoption is encouraged. If an entity applies this Standard for an earlier period it shall disclose that fact.**

Application Guidance

The following guidance illustrates aspects of the requirements in IPSAS 25. This Application Guidance is part of IPSAS 25.

Example Illustrating Paragraph 21: Accounting for a Performance-Related Bonus Plan

A performance-related bonus plan requires a government printing unit to pay a specified proportion of its surplus for the year to employees who meet pre-determined performance targets and serve throughout the year i.e., are in post on both the first and last day of the reporting period. If no employees leave during the year, the total bonus payments for the year will be 3% of actual surplus. The entity determines that staff turnover will reduce the payments to 2.5% of actual surplus.

The entity recognizes a liability and an expense of 2.5% of actual surplus.

Example Illustrating Paragraph 36: Accounting for a Multi-Employer Plan

Along with similar entities in State X, Local Government Unit A participates in a multi-employer defined benefit plan. Because the plan exposes the participating entities to actuarial risks associated with the current and former employees of other local government units participating in the plan, there is no consistent and reliable basis for allocating the obligation, plan assets and cost to individual local government units participating in the plan. Local Government Unit A therefore accounts for the plan as if it were a defined contribution plan. A funding valuation, which is not drawn up on the basis of assumptions compatible with the requirements of this Standard, shows a deficit of 480 million currency units in the plan. The plan has agreed under a binding arrangement a schedule of contributions with the participating employers in the plan that will eliminate the deficit over the next five years. Local Government Unit A's total contributions under the contract are 40 million currency units.

The entity recognizes a liability for the contributions adjusted for the time value of money and an equal expense in surplus or deficit.

Example Illustrating Paragraph 73: Limits on Recognition of Plan Asset

A defined benefit plan has the following characteristics:

Present value of the obligation	1100
Fair value of plan assets	(1190)
	(90)
Unrecognized actuarial losses	(110)

Example Illustrating Paragraph 73: Limits on Recognition of Plan Asset	
Unrecognized past service cost	(70)
Negative amount determined under paragraph 65	(270)
Present value of available future refunds and reductions in future contributions	60
The limit under paragraph 69(b) is computed as follows:	
Unrecognized actuarial losses	*110*
Unrecognized past service cost	*70*
Present value of available future refunds and reductions in future contributions	*60*
Limit	*240*
240 is less than 270. Therefore, the entity recognizes an asset of 240 and discloses that the limit in paragraph 69(b) reduced the carrying amount of the asset by 30 (see paragraph 141(f)(iii)).	

Example Illustrating Paragraph 78: Projected Unit Credit Method

A lump sum benefit is payable on termination of service and equal to 1% of final salary for each year of service. The salary in year 1 is 10,000 and is assumed to increase at 7% (compound) each year. The discount rate used is 10% per annum. The following table shows how the obligation builds up for an employee who is expected to leave at the end of year 5, assuming that there are no changes in actuarial assumptions. For simplicity, this example ignores the additional adjustment needed to reflect the probability that the employee may leave the entity at an earlier or later date.

Year	*1*	*2*	*3*	*4*	*5*
Benefit attributed to:					
– prior years	*0*	*131*	*262*	*393*	*524*
– current year (1% of final salary)	*131*	*131*	*131*	*131*	*131*
– current and prior years	*131*	*262*	*393*	*524*	*655*

Year	**1**	**2**	**3**	**4**	**5**
Opening obligation	*–*	*89*	*196*	*324*	*476*
Interest at 10%	*–*	*9*	*20*	*33*	*48*
Current service cost	*89*	*98*	*108*	*119*	*131*
Closing obligation	*89*	*196*	*324*	*476*	*655*

Note:

1. *The opening obligation is the present value of benefit attributed to prior years.*
2. *The current service cost is the present value of benefit attributed to the current year.*
3. *The closing obligation is the present value of benefit attributed to current and prior years.*

Examples Illustrating Paragraph 81: Attributing Benefit to Years of Service

1. A defined benefit plan provides a lump sum benefit of 100 payable on retirement for each year of service.

   A benefit of 100 is attributed to each year. The current service cost is the present value of 100. The present value of the defined benefit obligation is the present value of 100, multiplied by the number of years of service up to the reporting date.

   If the benefit is payable immediately when the employee leaves the entity, the current service cost and the present value of the defined benefit obligation reflect the date at which the employee is expected to leave. Thus, because of the effect of discounting, they are less than the amounts that would be determined if the employee left at the reporting date.

2. A plan provides a monthly pension of 0.2% of final salary for each year of service. The pension is payable from the age of 65.

   Benefit equal to the present value, at the expected retirement date, of a monthly pension of 0.2% of the estimated final salary payable from the expected retirement date until the expected date of death is attributed to each year of service. The current service cost is the present value of that benefit. The present value of the defined benefit obligation is the present value of monthly pension payments of 0.2% of final salary, multiplied by the number of years of service up to the reporting date. The current service cost and the present value of the defined benefit obligation are discounted because pension payments begin at the age of 65.

Examples Illustrating Paragraph 82: Vesting and Non-Vesting Benefits

1. A plan pays a benefit of 100 for each year of service. The benefits vest after 10 years of service.

   A benefit of 100 is attributed to each year. In each of the first 10 years, the current service cost and the present value of the obligation reflect the probability that the employee may not complete ten years of service.

2. A plan pays a benefit of 100 for each year of service, excluding service before the age of 25. The benefits vest immediately.

   No benefit is attributed to service before the age of 25 because service before that date does not lead to benefits (conditional or unconditional). A benefit of 100 is attributed to each subsequent year.

Examples Illustrating Paragraph 83: Attributing Benefits to Accounting Periods

1. A plan pays a lump sum benefit of 1,000 that vests after 10 years of service. The plan provides no further benefit for subsequent service.

   A benefit of 100 (1,000 divided by 10) is attributed to each of the first 10 years. The current service cost in each of the first 10 years reflects the probability that the employee may not complete 10 years of service. No benefit is attributed to subsequent years.

2. A plan pays a lump sum retirement benefit of 2,000 to all employees who are still employed at the age of 55 after 20 years of service, or who are still employed at the age of 65, regardless of their length of service.

   For employees who join before the age of 35, service first leads to benefits under the plan at the age of 35 (an employee could leave at the age of 30 and return at the age of 33, with no effect on the amount or timing of benefits). Those benefits are conditional on further service. Also, service beyond the age of 55 will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (2,000 divided by 20) to each year from the age of 35 to the age of 55.

   For employees who join between the ages of 35 and 45, service beyond twenty years will lead to no material amount of further benefits. For these employees, the entity attributes benefit of 100 (2,000 divided by 20) to each of the first twenty years.

   For an employee who joins at the age of 55, service beyond ten years will lead to no material amount of further benefits. For this employee, the entity attributes benefit of 200 (2,000 divided by 10) to each of the first 10 years.

   For all employees, the current service cost and the present value of the obligation reflect the probability that the employee may not complete the necessary period of service.

3. A postemployment medical plan reimburses 40% of an employee's postemployment medical costs if the employee leaves after more than 10 and less than 20 years of service and 50% of those costs if the employee leaves after 20 or more years of service.

   Under the plan's benefit formula, the entity attributes 4% of the present value of the expected medical costs (40% divided by 10) to each of the first ten years and 1% (10% divided by 10) to each of the second 10 years. The current service cost in each year reflects the probability that the employee may not complete the necessary period of service to earn part or all of the benefits. For employees expected to leave within 10 years, no benefit is attributed.

Examples Illustrating Paragraph 83: Attributing Benefits to Accounting Periods *continuation*

4. A postemployment medical plan reimburses 10% of an employee's postemployment medical costs if the employee leaves after more than 10 and less than 20 years of service and 50% of those costs if the employee leaves after 20 or more years of service.

   Service in later years will lead to a materially higher level of benefit than in earlier years. Therefore, for employees expected to leave after 20 or more years, the entity attributes benefit on a straight-line basis under paragraph 68. Service beyond 20 years will lead to no material amount of further benefits. Therefore, the benefit attributed to each of the first 20 years is 2.5% of the present value of the expected medical costs (50% divided by 20).

   For employees expected to leave between 10 and 20 years, the benefit attributed to each of the first 10 years is 1% of the present value of the expected medical costs. For these employees, no benefit is attributed to service between the end of the tenth year and the estimated date of leaving.

   For employees expected to leave within 10 years, no benefit is attributed.

Example Illustrating Paragraph 84: Attributing Benefits to Accounting Periods

Employees are entitled to a benefit of 3% of final salary for each year of service before the age of 55.

Benefit of 3% of estimated final salary is attributed to each year up to the age of 55. This is the date when further service by the employee will lead to no material amount of further benefits under the plan. No benefit is attributed to service after that age.

Example Illustrating Paragraph 113: Accounting for Past Service Cost

An entity operates a pension plan that provides a pension of 2% of final salary for each year of service. The benefits become vested after five years of service. On January 1, 20X9, the entity improves the pension to 2.5% of final salary for each year of service starting from January 1, 20X5. At the date of the improvement, the present value of the additional benefits for service from January 1, 20X5 to January 1, 20X9 is as follows:

Employees with more than five years service at 1/1/X9	150
Employees with less than five years service at 1/1/X9 (average period until vesting: three years)	120
	270

The entity recognizes 150 immediately because those benefits are already vested. The entity recognizes 120 on a straight-line basis over three years from January 1 20X9.

Example Illustrating Paragraphs 121–123: Reimbursements

Present value of obligation	1,241
Unrecognized actuarial gains	17
Liability recognized in statement of financial position	1,258
Rights from insurance policies that exactly match the amount and timing of some of the benefits payable under the plan. Those benefits have a present value of 1,092.	1,092

The unrecognized actuarial gains of 17 are the net cumulative actuarial gains on the obligation and on the reimbursement rights.

Example Illustrating Paragraph 125–127: Return on Plan Assets

At January 1, 20X7, the fair value of plan assets was 10,000 and net cumulative unrecognized actuarial gains were 760. On June 30, 20X7, the plan paid benefits of 1,900 and received contributions of 4,900. At December 31, 20X7, the fair value of plan assets was 15,000 and the present value of the defined benefit obligation was 14,792. Actuarial losses on the obligation for 20X7 were 60.

At January 1, 20X7, the reporting entity made the following estimates, based on market prices at that date:

	%
Interest and dividend income, after tax payable by the fund	9.25
Realized and unrealized gains on plan assets (after tax)	2.00
Administration costs	(1.00)
Expected rate of return	10.25

For 20X7, the expected and actual return on plan assets are as follows:

Return on 10,000 held for 12 months at 10.25%	1,025
Return on 3,000 held for six months at 5% (equivalent to 10.25% annually, compounded every six months)	150
Expected return on plan assets for 20X7	1,175
Fair value of plan assets at December 31, 20X7	15,000
Less fair value of plan assets at January 1, 20X7	(10,000)
Less contributions received	(4,900)
Add benefits paid	1,900
Actual return on plan assets	2,000

continued

Example Illustrating Paragraph 125-127: Return on Plan Assets
continuation

The difference between the expected return on plan assets (1,175) and the actual return on plan assets (2,000) is an actuarial gain of 825. Therefore, the cumulative net unrecognized actuarial gains are 1,525 (760 plus 825 minus 60). Under paragraph 105, the limits of the corridor are set at 1,500 (greater of: (i) 10% of 15,000 and (ii) 10% of 14,792). In the following year (20X8), the entity recognizes in surplus or deficit an actuarial gain of 25 (1,525 minus 1,500) divided by the expected average remaining working life of the employees concerned.

The expected return on plan assets for 20X8 will be based on market expectations at January 1 20X8 for returns over the entire life of the obligation.

Example Illustrating Paragraph 135: Accounting for a Curtailment Without a Settlement

An entity is required by legislation to discontinue the direct provision of waste collection and waste disposal services. Employees of this discontinued segment will earn no further benefits. This is a curtailment without a settlement. Using current actuarial assumptions (including current market interest rates and other current market prices) immediately before the curtailment, the entity has a defined benefit obligation with a net present value of 1,000, plan assets with a fair value of 820 and net cumulative unrecognized actuarial gains of 50. The curtailment reduces the net present value of the obligation by 100 to 900.

Of the previously unrecognized actuarial gains, 10% (100/1,000) relates to the part of the obligation that was eliminated through the curtailment. Therefore, the effect of the curtailment is as follows:

	Before curtailment	*Curtailment gain*	*After curtailment*
Net present value of obligation	*1000*	*(100)*	*900*
Fair value of plan assets	*(820)*	*–*	*(820)*
	180	*(100)*	*80*
Unrecognized actuarial gains	*50*	*(5)*	*45*
Net liability recognized in statement of financial position	*230*	*(105)*	*125*

Example Illustrating Paragraphs 166 to 168: Determining the Initial Liability

At December 31 2010, an entity's statement of financial position includes a pension liability of 100. The entity adopts this Standard as of January 1 2011, when the present value of the obligation under the Standard is 1,300 and the fair value of plan assets is 1,000. On January 1 2005 the entity had improved pensions (cost for non-vested benefits: 160; and average remaining period at that date until vesting: 10 years).

The initial effect is as follows:

Present value of the obligation	*1,300*
Fair value of plan assets	*(1,000)*
Minus: past service cost to be recognized in later periods (160 × 4/10)	*(64)*
Initial liability	*236*
Liability already recognized under previous policy	*100*
Additional liability	*136*

The entity recognizes the additional liability of 136 in opening accumulated surpluses or deficits.

Implementation Guidance A—Funded Defined Benefit Plan

This implementation guidance accompanies, but is not part of, IPSAS 25.

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

Background Information

The following information is given about a funded defined benefit plan. To keep interest computations simple, all transactions are assumed to occur at the year-end. The present value of the obligation and the fair value of the plan assets were both 1,000 at January 1, 20X7. Net cumulative unrecognized actuarial gains at that date were 140.

	20X7	*20X8*	*20X9*
Discount rate at start of year	10.0%	9.0%	8.0%
Expected rate of return on plan assets at start of year	12.0%	11.1%	10.3%
Current service cost	130	140	150
Benefits paid	150	180	190
Contributions paid	90	100	110
Present value of obligation at December 31	1,141	1,197	1,295
Fair value of plan assets at December 31	1,092	1,109	1,093
Expected average remaining working lives of employees (years)	10	10	10

In 20X8, the plan was amended to provide additional benefits with effect from January 1, 20X8. The present value as at January 1, 20X8 of additional benefits for employee service before January 1, 20X8 was 50 for vested benefits and 30 for non-vested benefits. As at January 1, 20X8, the entity estimated that the average period until the non-vested benefits would become vested was 3 years; the past service cost arising from additional non-vested benefits is therefore recognized on a straight-line basis over 3 years. The past service cost arising from additional vested benefits is recognized immediately (paragraph 112 of the Standard). The entity has adopted a policy of recognizing actuarial gains and losses under the minimum requirements of paragraph 106.

Changes in the Present Value of the Obligation and in the Fair Value of the Plan Assets

The first step is to summarize the changes in the present value of the obligation and in the fair value of the plan assets and use this to determine the amount of the actuarial gains or losses for the period. These are as follows:

	20X7	*20X8*	*20X9*
Present value of obligation, January1	1,000	1,141	1,197
Interest cost	100	103	96
Current service cost	130	140	150
Past service cost—non-vested benefits	–	30	–
Past service cost—vested benefits	–	50	–
Benefits paid	(150)	(180)	(190)
Actuarial (gain) loss on obligation (balancing figure)	61	(87)	42
Present value of obligation, December 31	1,141	1,197	1,295
Fair value of plan assets, January 1	1,000	1,092	1,109
Expected return on plan assets	120	121	114
Contributions	90	100	110
Benefits paid	(150)	(180)	(190)
Actuarial gain (loss) on plan assets (balancing figure)	32	(24)	(50)
Fair value of plan assets, December 31	1,092	1,109	1,093

Limits of the Corridor

The next step is to determine the limits of the corridor and then compare these with the cumulative unrecognized actuarial gains and losses in order to determine the net actuarial gain or loss to be recognized in the following period. Under paragraph 105 of the Standard, the limits of the corridor are set at the greater of:

(a) 10% of the present value of the obligation before deducting plan assets; and

(b) 10% of the fair value of any plan assets.

These limits, and the recognized and unrecognized actuarial gains and losses, are as follows:

	20X7	20X8	20X9
Net cumulative unrecognized actuarial gains (losses) at January1	140	107	170
Limits of corridor at January 1	100	114	120
Excess [A]	40	–	50
Average expected remaining working lives (years) [B]	10	10	10
Actuarial gain (loss) to be recognized [A/B]	4	–	5
Unrecognized actuarial gains (losses) at January 1	140	107	170
Actuarial gain (loss) for year—obligation	(61)	87	(42)
Actuarial gain (loss) for year—plan assets	32	(24)	(50)
Subtotal	111	170	78
Actuarial (gain) loss recognized	(4)	–	(5)
Unrecognized actuarial gains (losses) at December 31	107	170	73

Amounts Recognized in the Statement of Financial Position and Statement of Financial Performance, and Related Analyses

The final step is to determine the amounts to be recognized in the statement of financial position and the statement of financial performance, and the related analyses to be disclosed in accordance with paragraph 141(f), (g) and (m) of the Standard (the analyses required to be disclosed in accordance with paragraph 141(c) and (e) are given in the section of this Implementation Guidance, "Changes in the Present Value of the Obligation and in the Fair Value of the Plan Assets." These are as follows.

	20X7	20X8	20X9
Present value of the obligation	1,141	1,197	1,295
Fair value of plan assets	(1,092)	(1,109)	(1,093)
	49	88	202
Unrecognized actuarial gains (losses)	107	170	73
Unrecognized past service cost—non-vested benefits	–	(20)	(10)
Liability recognized in statement of financial position	**156**	**238**	**265**
Current service cost	130	140	150
Interest cost	100	103	96
Expected return on plan assets	(120)	(121)	(114)
Net actuarial (gain) loss recognized in year	(4)	–	(5)
Past service cost—non-vested benefits	–	10	10
Past service cost—vested benefits	–	50	–
Expense recognized in statement of financial performance	**106**	**182**	**137**
Actual return on plan assets			
Expected return on plan assets	120	121	114
Actuarial gain (loss) on plan assets	32	(24)	(50)
Actual return on plan assets	152	97	64

Note: see example illustrating paragraphs 121–123 for presentation of reimbursements.

Implementation Guidance B—Illustrative Disclosures

This implementation guidance accompanies, but is not part of IPSAS 25. Extracts from notes show how the required disclosures may be aggregated in the case of an entity that provides a variety of employee benefits. These extracts do not necessarily conform with all the disclosure and presentation requirements of IPSAS 25 and other Standards. In particular, they do not illustrate the disclosure of:

(a) *Accounting policies for employee benefits (see IPSAS 1, "Presentation of Financial Statements"). Paragraph 141(a) of the Standard requires this disclosure to include the entity's accounting policy for recognizing actuarial gains and losses.*

(b) *A general description of the type of plan (paragraph 141(b)).*

(c) *A narrative description of the basis used to determine the overall expected rate of return on assets (paragraph 141(l)).*

(d) *Employee benefits granted to key management personnel (see IPSAS 20, "Related Party Transactions").*

(e) *Share-based employee benefits (see the international or national accounting standard dealing with share-based payments).*

Employee Benefit Obligations

The amounts recognized in the statement of financial position are as follows:

	Defined benefit pension plans		Postemployment medical benefits	
	20X8	*20X7*	*20X8*	*20X7*
Present value of funded obligations	20,300	17,400	–	–
Fair value of plan assets	(18,420)	(17,280)	–	–
	1,880	120	–	–
Present value of unfunded obligations	2,000	1,000	7,337	6,405
Unrecognized actuarial gains (losses)	(1,605)	840	(2,707)	(2,607)
Unrecognized past service cost	(450)	(650)	–	–
Net liability	1,825	1,310	4,630	3,798
Amounts in the statement of financial position:				
liabilities	1,825	1,400	4,630	3,798
assets	–	(90)	–	–
Net liability	1,825	1,310	4,630	3,798

The pension plan assets include ordinary shares issued by [name of reporting entity] with a fair value of 317 (20X7: 281). Plan assets also include property occupied by [name of reporting entity] with a fair value of 200 (20X7: 185).

The amounts recognized in surplus or deficit are as follows:

	Defined benefit pension plans		Postemployment medical benefits	
	20X8	*20X7*	*20X8*	*20X7*
Current service cost	850	750	479	411
Interest on obligation	950	1,000	803	705
Expected return on plan assets	(900)	(650)		
Net actuarial losses (gains) recognized in year	(70)	(20)	150	140
Past service cost	200	200		
Losses (gains) on curtailments and settlements	175	(390)		
Total, included in employee benefits expense	1,205	890	1,432	1,256
Actual return on plan assets	600	2,250	–	–

Changes in the present value of the defined benefit obligation are as follows:

	Defined benefit pension plans		Postemployment medical benefits	
	20X8	*20X7*	*20X8*	*20X7*
Opening defined benefit obligation	18,400	11,600	6,405	5,439
Service cost	850	750	479	411
Interest cost	950	1,000	803	705
Actuarial losses (gains)	2,350	950	250	400
Losses (gains) on curtailments	(500)	–		
Liabilities extinguished on settlements	–	(350)		
Liabilities assumed in an entity combination	–	5,000		
Exchange differences on foreign plans	900	(150)		
Benefits paid	(650)	(400)	(600)	(550)
Closing defined benefit obligation	22,300	18,400	7,337	6,405

Changes in the fair value of plan assets are as follows:

	Defined benefit pension plans	
	20X8	*20X7*
Opening fair value of plan assets	17,280	9,200
Expected return	900	650
Actuarial gains (losses)	(300)	1,600
Assets distributed on settlements	(400)	–
Contributions by employer	700	350
Assets acquired in an entity combination	–	6,000
Exchange differences on foreign plans	890	(120)
Benefits paid	(650)	(400)
	18,420	17,280

The entity expects to contribute 900 to its defined benefit pension plans in 20X9.

The major categories of plan assets as a percentage of total plan assets are as follows:	*20X8*	*20X7*
European equities	30%	35%
North American equities	16%	15%
European bonds	31%	28%
North American bonds	18%	17%
Property	5%	5%

Principal actuarial assumptions at the reporting date (expressed as weighted averages):

	20X8	*20X7*
Discount rate at December 31	5%	6.5%
Expected return on plan assets at December 31	5.4%	7%
Future salary increases	5%	4%
Future pension increases	3%	2%
Proportion of employees opting for early retirement	30%	30%
Annual increase in healthcare costs	8%	8%
Future changes in maximum state healthcare benefits	3%	2%

Assumed healthcare cost trend rates have a significant effect on the amounts recognized in surplus or deficit. A one percentage point change in assumed healthcare cost trend rates would have the following effects:

	One percentage point increase	**One percentage point decrease**
Effect on the aggregate of the service cost and interest cost	190	(150)
Effect on defined benefit obligation	1,000	(900)

Amounts for the current and previous four periods are as follows:

Defined benefit pension plans

	20X8	*20X7*	*20X6*	*20X5*	*20X4*
Defined benefit obligation	(22,300)	(18,400)	(11,600)	(10,582)	(9,144)
Plan assets	18,420	17,280	9,200	8,502	10,000
Surplus (deficit)	(3,880)	(1,120)	(2,400)	(2,080)	856
Experience adjustments on plan liabilities	(1,111)	(768)	(69)	543	(642)
Experience adjustments on plan assets	(300)	1,600	(1,078)	(2,890)	2,777

Postemployment medical benefits

	20X8	*20X7*	*20X6*	*20X5*	*20X4*
Defined benefit obligation	7,337	6,405	5,439	4,923	4,221
Experience adjustments on plan liabilities	(232)	829	490	(174)	(103)

The reporting entity also participates in a defined benefit plan for all local government units in Jurisdiction Y that provides pensions linked to final salaries and is funded on a pay-as-you-go basis. It is not practicable to determine the present value of the economic entity's obligation or the related current service cost as the plan computes its obligations on a basis that differs materially from the basis used in [name of reporting entity]'s financial statements. [describe basis] On that basis, the plan's financial statements to June 30 20X6 show an unfunded liability of 27,525. The unfunded liability will result in future payments by participating employers. The plan has approximately 75,000 members, of whom approximately 5,000 are current or former employees of [name of reporting entity] or their dependants. The expense recognized in the statement of financial performance, which is equal to contributions due for the year, and is not included in the above amounts, was 230 (20X7: 215). The reporting entity's future contributions may be increased substantially if other entities withdraw from the plan.

Implementation Guidance C: Illustration of the Application of Paragraph 70

This implementation guidance accompanies, but is not part of, IPSAS 25.

The issue

Paragraph 69 of the Standard imposes a ceiling on the defined benefit asset that can be recognized.

69. **The amount determined under paragraph 65 may be negative (an asset). An entity shall measure the resulting asset at the lower of:**

    (a) **The amount determined under paragraph 65** [i.e., the surplus/deficit in the plan plus (minus) any unrecognized losses (gains)]**; and**

    (b) **The total of:**

        (i) **Any cumulative unrecognized net actuarial losses and past service cost (see paragraphs 105, 106 and 112); and**

        (ii) **The present value of any economic benefits available in the form of refunds from the plan or reductions in future contributions to the plan. The present value of these economic benefits shall be determined using the discount rate specified in paragraph 91.**

Without paragraph 70 (see below), paragraph 69(b)(i) has the following consequence: sometimes deferring the recognition of an actuarial loss (gain) in determining the amount specified by paragraph 65 leads to a gain (loss) being recognized in the statement of financial performance.

The following example illustrates the effect of applying paragraph 69 without paragraph 70. The example assumes that the entity's accounting policy is not to recognize actuarial gains and losses within the corridor and to amortize actuarial gains and losses outside the corridor. (Whether the corridor is used is not significant. The issue can arise whenever there is deferred recognition under paragraph 65.)

Example 1 – Effect of applying paragraph 69 without paragraph 70

	A	B	C	D=A+C	E=B+C	F= lower of D and E	G
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses unrecognized under paragraph 65	Paragraph 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	100	0	0	100	0	0	–
2	70	0	30	100	30	30	30

At the end of year 1, there is a surplus of 100 in the plan (column A in the table above), but no economic benefits are available to the entity either from refunds or reductions in future contributions* (column B). There are no unrecognized gains and losses under paragraph 65 (column C). So, if there were no asset ceiling, an asset of 100 would be recognized, being the amount specified by paragraph 65 (column D). The asset ceiling in paragraph 69 restricts the asset to nil (column F).

In year 2 there is an actuarial loss in the plan of 30 that reduces the surplus from 100 to 70 (column A) the recognition of which is deferred under paragraph 65 (column C). So, if there were no asset ceiling, an asset of 100 (column D) would be recognized. The asset ceiling without paragraph 70 would be 30 (column E). An asset of 30 would be recognized (column F), giving rise to an increase in revenue (column G) even though all that has happened is that a surplus from which the entity cannot benefit has decreased.

A similarly counter-intuitive effect could arise with actuarial gains (to the extent that they reduce cumulative unrecognized actuarial losses).

Paragraph 70

Paragraph 70 prohibits the recognition of gains (losses) that arise solely from past service cost and actuarial losses (gains).

70. **The application of paragraph 69 shall not result in a gain being recognized solely as a result of an actuarial loss or past service cost in the current period or in a loss being recognized solely as a result of an actuarial gain in the current period. The entity shall therefore recognize immediately under paragraph 65 the following, to the extent that they arise while the defined benefit asset is determined in accordance with paragraph 69(b):**

* Based on the current terms of the plan.

(a) **Net actuarial losses of the current period and past service cost of the current period to the extent that they exceed any reduction in the present value of the economic benefits specified in paragraph 69(b)(ii). If there is no change or an increase in the present value of the economic benefits, the entire net actuarial losses of the current period and past service cost of the current period shall be recognized immediately under paragraph 65.**

(b) **Net actuarial gains of the current period after the deduction of past service cost of the current period to the extent that they exceed any increase in the present value of the economic benefits specified in paragraph 69(b)(ii). If there is no change or a decrease in the present value of the economic benefits, the entire net actuarial gains of the current period after the deduction of past service cost of the current period shall be recognized immediately under paragraph 65.**

Examples

The following examples illustrate the result of applying paragraph 70. As above, it is assumed that the entity's accounting policy is not to recognize actuarial gains and losses within the corridor and to amortize actuarial gains and losses outside the corridor. For the sake of simplicity, the periodic amortization of unrecognized gains and losses outside the corridor is ignored in the examples.

Example 1 continued – Adjustment when there are actuarial losses and no change in the economic benefits available

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses unrecognized under paragraph 65	Paragraph 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	100	0	0	100	0	0	–
2	70	0	0	70	0	0	0

The facts are as in example 1 above. Applying paragraph 70, there is no change in the economic benefits available to the entity* so the entire actuarial loss of 30 is recognized immediately under paragraph 65 (column D). The asset ceiling remains at nil (column F) and no gain is recognized.

In effect, the actuarial loss of 30 is recognized immediately, but is offset by the reduction in the effect of the asset ceiling.

	Asset in Statement of Financial Position under paragraph 65 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(100)	0
Year 2	70	(70)	0
Gain (loss)	(30)	(30)	0

In the above example, there is no change in the present value of the economic benefits available to the entity. The application of paragraph 70 becomes more

* The term "economic benefits available to the entity" is used to refer to those economic benefits that qualify for recognition under paragraph 69(b)(ii).

complex when there are changes in present value of the economic benefits available, as illustrated in the following examples.

Example 2 – Adjustment when there are actuarial losses and a decrease in the economic benefits available

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses unrecognized under paragraph 65	Paragraph 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	60	30	40	100	70	70	–
2	25	20	50	75	70	70	0

At the end of year 1, there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognized losses of 40 under paragraph 65 (column C). So, if there were no asset ceiling, an asset of 100 would be recognized (column D). The asset ceiling restricts the asset to 70 (column F).

In year 2, an actuarial loss of 35 in the plan reduces the surplus from 60 to 25 (column A). The economic benefits available to the entity fall by 10 from 30 to 20 (column B). Applying paragraph 70, the actuarial loss of 35 is analysed as follows:

Actuarial loss equal to the reduction in economic benefits	10
Actuarial loss that exceeds the reduction in economic benefits	25

In accordance with paragraph 70, 25 of the actuarial loss is recognized immediately under paragraph 65* (column D). The reduction in economic benefits of 10 is included in the cumulative unrecognized losses that increase to 50 (column C). The asset ceiling, therefore, also remains at 70 (column E) and no gain is recognized.

In effect, an actuarial loss of 25 is recognized immediately, but is offset by the reduction in the effect of the asset ceiling.

* The application of paragraph 70 allows the recognition of some actuarial gains and losses to be deferred under paragraph 65 and, hence, to be included in the calculation of the asset ceiling. For example, cumulative unrecognized actuarial losses that have built up while the amount specified by paragraph 69(b) is not lower than the amount specified by paragraph 65 will not be recognized immediately at the point that the amount specified by paragraph 69(b) becomes lower. Instead their recognition will continue to be deferred in line with the entity's accounting policy. The cumulative unrecognized losses in this example are losses the recognition of which is deferred even though paragraph 70 applies.

	Asset in statement of financial position under paragraph 65 (column D above)	Effect of the asset ceiling	Asset ceiling (column F above)
Year 1	100	(30)	70
Year 2	75	(5)	70
Gain (loss)	(25)	25	0

Example 3 – Adjustment when there are actuarial gains and a decrease in the economic benefits available to the entity

	A	B	C	D=A+C	E=B+C	F= lower of D and E	G
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses unrecognized under paragraph 65	Paragraph 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	60	30	40	100	70	70	–
2	110	25	40	150	65	65	(5)

At the end of year 1 there is a surplus of 60 in the plan (column A) and economic benefits available to the entity of 30 (column B). There are unrecognized losses of 40 under paragraph 65 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognized (column D). The asset ceiling restricts the asset to 70 (column F).

In year 2, an actuarial gain of 50 in the plan increases the surplus from 60 to 110 (column A). The economic benefits available to the entity decrease by 5 (column B). Applying paragraph 70, there is no increase in economic benefits available to the entity. Therefore, the entire actuarial gain of 50 is recognized immediately under paragraph 65 (column D) and the cumulative unrecognized loss under paragraph 65 remains at 40 (column C). The asset ceiling decreases to 65 because of the reduction in economic benefits. That reduction is not an actuarial loss as defined by IPSAS 25 and therefore does not qualify for deferred recognition.

In effect, an actuarial gain of 50 is recognized immediately, but is (more than) offset by the increase in the effect of the asset ceiling.

	Asset in Statement of Financial Position under paragraph 65 (column D above)	**Effect of the asset ceiling**	**Asset ceiling (column F above)**
Year 1	100	(30)	70
Year 2	150	(85)	65
Gain (loss)	50	(55)	(5)

In both examples 2 and 3 there is a reduction in economic benefits available to the entity. However, in example 2 no loss is recognized whereas in example 3 a loss is recognized. This difference in treatment is consistent with the treatment of changes in the present value of economic benefits before application of paragraph 70. The purpose of paragraph 70 is solely to prevent gains (losses) being recognized because of past service cost or actuarial losses (gains). As far as is possible, all other consequences of deferred recognition and the asset ceiling are left unchanged.

Example 4 – Adjustment in a period in which the asset ceiling ceases to have an effect

	A	**B**	**C**	**D=A+C**	**E=B+C**	**F= lower of D and E**	**G**
Year	Surplus in plan	Economic benefits available (paragraph 69(b)(ii))	Losses unrecognized under paragraph 65	Paragraph 65	Paragraph 69(b)	Asset ceiling, i.e., recognized asset	Gain recognized in year 2
1	60	25	40	100	65	65	–
2	(50)	0	115	65	115	65	0

At the end of year 1 there is a surplus of 60 in the plan (column A) and economic benefits are available to the entity of 25 (column B). There are unrecognized losses of 40 under paragraph 65 that arose before the asset ceiling had any effect (column C). So, if there were no asset ceiling, an asset of 100 would be recognized (column D). The asset ceiling restricts the asset to 65 (column F).

In year 2, an actuarial loss of 110 in the plan reduces the surplus from 60 to a deficit of 50 (column A). The economic benefits available to the entity decrease from 25 to 0 (column B). To apply paragraph 70, it is necessary to determine how much of the actuarial loss arises while the defined benefit asset is determined in accordance with paragraph 69(b). Once the surplus becomes a deficit, the amount determined by paragraph 65 is lower than the net total under paragraph 69(b). So, the actuarial loss that arises while the defined benefit asset is determined in accordance with paragraph

69(b) is the loss that reduces the surplus to nil, i.e., 60. The actuarial loss is, therefore, analyzed as follows:

Actuarial loss that arises while the defined benefit asset is measured under paragraph 69(b):

Actuarial loss that equals the reduction in economic benefits	25
Actuarial loss that exceeds the reduction in economic benefits	35
	60
Actuarial loss that arises while the defined benefit asset is measured under paragraph 65	50
Total actuarial loss	110

In accordance with paragraph 70, 35 of the actuarial loss is recognized immediately under paragraph 65 (column D); 75 (25 plus 50) of the actuarial loss is included in the cumulative unrecognized losses which increase to 115 (column C). The amount determined under paragraph 65 becomes 65 (column D) and under paragraph 69(b) becomes 115 (column E). The recognized asset is the lower of the two, i.e., 65 (column F), and no gain or loss is recognized (column G).

In effect, an actuarial loss of 35 is recognized immediately, but is offset by the reduction in the effect of the asset ceiling.

	Asset in Statement of Financial Position under paragraph 65 (column D above)	Effect of the asset ceiling	Asset ceiling (column F above)
Year 1	100	(35)	65
Year 2	65	0	65
Gain (loss)	(35)	35	0

Notes

1. In applying paragraph 70 in situations when there is an increase in the present value of the economic benefits available to the entity, it is important to remember that the present value of the economic benefits available cannot exceed the surplus in the plan.*

2. In practice, benefit improvements often result in a past service cost and an increase in expected future contributions due to increased current service costs

* In the example illustrating paragraph 73 of IPSAS 25 the present value of available future refunds in contributions could not exceed the surplus in the plan of 90.

of future years. The increase in expected future contributions may increase the economic benefits available to the entity in the form of anticipated reductions in those future contributions. The prohibition against recognizing a gain solely as a result of past service cost in the current period does not prevent the recognition of a gain because of an increase in economic benefits. Similarly, a change in actuarial assumptions that causes an actuarial loss may also increase expected future contributions and, hence, the economic benefits available to the entity in the form of anticipated reductions in future contributions. Again, the prohibition against recognizing a gain solely as a result of an actuarial loss in the current period does not prevent the recognition of a gain because of an increase in economic benefits.

Basis for Conclusions

This Basis for Conclusions accompanies, but does not form part of, the IPSAS.

Introduction

BC1. The labor-intensive character of the operations of very many public sector entities means that expenses and liabilities related to employee benefits are likely to be particularly significant in evaluating the financial performance and financial position of those entities. It is therefore essential that the general purpose financial statements of public sector entities report expenses and liabilities related to employee benefits and that these should be determined on a systematic and consistent basis. It is also important that relevant disclosures are provided to users.

BC2. Development of a Standard on employee benefits has previously been deferred for two reasons. First, the IPSASB decided to prioritize resources on public sector specific projects, including projects on social benefits provided by public sector entities in non-exchange transactions and revenue from non-exchange transactions. Second, in the earlier part of this decade it appeared possible that there might have been very significant changes to IAS 19. The IPSASB notes that the the International Accounting Standards Board (IASB) currently has a project on post-retirement benefits underway. The project is being conducted in two phases, which involve a fundamental review of all aspects of postemployment benefit accounting. Phase One is part of the short-term convergence project of the IASB and the Financial Accounting Standards Board. Whilst this project may identify issues that can be resolved relatively quickly, the IPSASB considers that the development of proposals for fundamental changes to accounting for postemployment benefits is not sufficiently advanced to justify deferral of this Standard. The IPSASB will continue to monitor developments in the IASB's project.

Composite Social Security Programs and State Plans

BC3. In many jurisdictions postemployment benefits are paid through composite social security programs. Composite social security programs also provide benefits that are not consideration in exchange for service rendered by employees or past employees. The IPSASB concluded that, because they are particularly significant in some jurisdictions, including a number of European countries, composite social security programs should be defined and requirements provided for their treatment. This Standard includes in paragraph 10 a definition of composite social security programs that encompasses both components of such programs.

BC4. This Standard does not deal with all potential obligations of public sector entities under composite social security programs. As this Standard deals with employee benefits of reporting entities, only benefits payable under composite social security programs as consideration in exchange for service rendered by employees of the reporting entity are within its scope. The IPSASB is addressing certain other benefits payable under composite social security schemes in a separate project dealing with social benefits.

BC5. This Standard retains the requirement in IAS 19 that an entity accounts for a state plan in the same way as for a multi-employer plan. The IPSASB concluded that it should provide further commentary to clarify the approach to accounting for state plans by public sector entities. Paragraph 46 provides a rebuttable presumption that the state plan will be characterized as a defined benefit plan by the controlling entity. Only where that presumption is rebutted is the state plan accounted for as a defined contribution plan.

Defined Benefit Plans with Participating Entities under Common Control

BC6. In the public sector there are likely to be many cases where entities under common control participate in defined benefit plans. IAS 19 includes commentary on defined benefit plans that share risks between entities under common control. The IPSASB considered that the requirements in IAS 19 are appropriate in the public sector. The IPSASB also considered it appropriate to emphasize that, unless there is a contractual agreement, binding arrangement or stated policy for charging the net defined benefit cost for the plan as a whole to an individual entity, it is inappropriate for controlled entities to account on a defined benefit basis. In such cases the controlling entity should account for such plans on a defined benefit basis in its consolidated financial statements. Controlled entities account on a defined contribution basis, identify the controlling entity and disclose that the controlling entity is accounting on a defined benefit basis in its consolidated financial statements. This is reflected in paragraph 41. Controlled entities also make the disclosures specified in paragraph 42.

Discount Rates

BC7. IAS 19 requires adoption of a discount rate based on the market yields at the reporting date on high quality corporate bonds. The IPSASB decided that the discount rate should reflect the time value of money and considered that entities should be left to determine the rate that best achieves that objective. The IPSASB considered that the time value of money may be best reflected by reference to market yields on government bonds, high quality corporate bonds or any other financial instrument. The discount rate used is not intended to incorporate the risk associated with defined benefit obligations or entity-specific credit risk. There is an additional disclosure requirement at paragraph 141(n)(ii) informing users of the basis on which the discount rate has been determined.

BC8. The IPSASB considered whether it should provide guidance to assist entities operating in jurisdictions where there is neither a deep market in government bonds nor a deep market in high quality corporate bonds to determine a discount rate that reflects the time value of money. The IPSASB acknowledges that determination of an appropriate discount rate is likely to be a difficult issue for entities operating in such jurisdictions, and that such entities may be in the process of migrating, or have recently migrated, to the accrual basis of accounting. However, the IPSASB concluded that this is not an issue that applies only in the public sector and that there is an insufficiently clear public sector specific reason to provide such guidance.

Actuarial Gains and Losses—the Corridor

BC9. The IPSASB considered accounting requirements for actuarial gains and losses. In particular the IPSASB considered whether the approach in IAS 19 known as the corridor, whereby actuarial gains and losses only have to be recognized immediately if they fall outside pre-determined parameters, related to the fair value of plan assets and the carrying amount of defined benefit obligations at the last reporting date, should be adopted in this Standard. The IPSASB recognized the view of those who argue that that the corridor approach is conceptually unsound and leads to an unjustifiable deferral of revenue and expenses. However, the IPSASB concluded that there is no public sector specific reason to remove the corridor provisions and require the immediate recognition of all actuarial gains and losses. The IPSASB therefore decided to retain the corridor approach in this Standard and to allow entities to select any of the 3 options permitted by IAS 19 for dealing with actuarial gains and losses that are within the "corridor." These are:

(a) Non-recognition;

(b) Recognition on a systematic and consistent basis of actuarial gains and losses related to all defined benefit plans in the statement of financial performance; and

(c) Recognition on a systematic and consistent basis of actuarial gains and losses related to all defined benefit plans outside the statement of financial performance.

Actuarial Gains and Losses: Presentation where Recognition is Outside the Statement of Financial Performance

BC10. When the IPSASB developed ED 31, "Employee Benefits," IAS 19 (2004) and IAS 1 required "the statement of changes in equity" to be re-termed "the statement of recognized income and expense" where an entity adopted a policy of recognizing actuarial gains and losses for all its defined benefit plans outside the income statement. The suite of financial statements in IPSAS 1, "Presentation of Financial Statements" does not include a "statement of recognized revenue and expense." The IPSASB therefore considered whether IPSAS 1 should be amended to re-term the "statement of changes in net assets/equity" the "statement of recognized revenue and expense," under certain circumstances, or whether entities should be permitted to recognize actuarial gains and losses in the existing "statement of changes in net assets/equity," which is required by IPSAS 1. The IPSASB initially concluded that, consistent with its objective of promoting convergence with IFRS, it should effect a consequential amendment to IPSAS 1 to re-term "the statement of net assets/equity" as the "statement of recognized revenue and expense" when it only includes certain line items, including actuarial gains and losses. This approach was generally supported at consultation.

BC11. The IASB has subsequently issued a revised IAS 1 that includes a consequential amendment to IAS 19. This deletes references to the statement of recognized income and expense and requires actuarial gains and losses recognized outside profit or loss to be presented as a component of other comprehensive income. The IPSASB has not yet considered the revised IAS 1. Rather than adopt a treatment that aims to converge with an approach in IFRS that has already been superseded, the IPSASB decided to adopt a requirement that, where actuarial gains and losses are recognized outside the statement of financial performance, they should be presented in the statement of changes in net assets/equity.

Reimbursements

BC12. Although the requirement in relation to reimbursements in IAS 19 is general, the commentary is written from the perspective of insurance policies that are not qualifying insurance policies and are therefore not plan assets. The IPSASB considered whether there may be cases in the public sector where another public sector entity may enter into a legally binding commitment to provide part or all of the expenditure required to settle a defined benefit obligation of the reporting entity. The IPSASB considered that there may be such circumstances. ED 31 therefore included expanded commentary to acknowledge that such circumstances may arise. Some submissions considered that this revised commentary was confusing. Acknowledging this view the IPSASB decided to use the same commentary as in IAS 19 and to put the onus on entities to determine whether they have an asset arising from a right to reimbursement by reference to the definition of an asset in the IPSASB literature.

Other Long-Term Employee Benefits: Long-Term Disability Benefits

BC13. IAS 19 lists long-term disability benefits as an example of an "other long-term employee benefit." IAS 19 states that "the measurement of other long-term employee benefits is not usually subject to the same degree of uncertainty as the measurement of postemployment benefits" and that "the introduction of, or changes to, other long-term employee benefits rarely causes a material amount of past service cost." In the public sector, disability benefits related to certain areas of service provision, such as the military, may be financially highly significant and related actuarial gains or losses volatile.

BC14. IPSAS 25 therefore provides a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of postemployment benefits. Where this presumption is rebutted the entity considers whether some or all long-term disability payments should be accounted for using the same requirements as for postemployment benefits.

Other Long-Term Employee Benefits: Compensation Payable by the Reporting Entity until an Individual Enters New Employment

BC15. Although it does not consider it likely that such circumstances are widespread, the IPSASB acknowledged that there may be cases where a reporting entity is contractually bound to make compensation payments separate from a termination benefit to a past-employee until he/she enters new employment. The list of other long-term benefits in paragraph 147 was therefore amended to include such circumstances.

Implementation Arrangements

BC16. The IPSASB acknowledged that applying the requirements of this Standard in relation to liabilities relating to obligations arising from defined benefit plans may prove challenging for many public sector entities. Currently, many public sector entities may not be recognizing liabilities related to such obligations and may therefore not have the systems in place to provide the information required for reporting under the requirements of this Standard. Where entities are recognizing liabilities relating to obligations arising from defined benefit plans this may be on a different basis to that required by this Standard. In some cases adoption of this Standard might give rise to tensions with budgetary projections and other prospective information.

BC17. IAS 19 requires entities adopting that Standard to determine a transitional liability. Where the amount of the transitional liability is more than the liability that would have been recognized at the same date under the previous accounting policy, IAS 19 permits entities to expense that difference on a straight-line basis over a period up to five years from the date of adoption.

BC18. The impact on financial performance and financial position of increases in liabilities arising from adoption of this Standard will be an issue for many public sector entities. However, as indicated in paragraph BC16, a more immediate issue may be obtaining the information in the first place. The IPSASB therefore concluded that, in order to give public sector entities the time to develop new systems and upgrade existing systems, this Standard should become effective for reporting periods commencing on or after January 1 2011. Consistent with this objective, in the first year of adoption comparative information is not required. Earlier adoption is encouraged.

BC19. In paragraph 166, this Standard requires entities to determine an initial liability for defined benefit plans. Because entities do not have to adopt the Standard until reporting periods commencing on or after January 1 2011, the IPSASB concluded that it is not necessary to introduce a transitional provision permitting entities to expense over a period any difference between the initial liability and the liability that would have been recognized under the previous accounting policy. In order to avoid a potential distortion of financial performance in the first year of adoption, and, for consistency with IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors," this Standard requires the difference between the initial liability and the liability that would have been recognized at the same date under the previous accounting policy to be taken to opening accumulated surpluses or deficits.

BC20. The IPSASB also considered whether, in the light of possible difficulties for reporting entities in assembling information, it would be appropriate to provide relief from certain disclosure requirements in paragraph 141 of this Standard. These disclosures require opening balances relating to a number of components of obligations and plan assets or trend information covering the current reporting period and previous four reporting periods. The IPSASB concluded that, because some entities may require the full lead-in period to develop systems, such relief is appropriate. It is therefore included in the Standard in paragraphs 173 and 175.

Comparison with IAS 19

IPSAS 25, "Employee Benefits" is drawn primarily from IAS 19, "Employee Benefits" (2004). The main differences between IPSAS 25 and IAS 19 are as follows:

- IPSAS 25 contains additional guidance on public sector bonus plans.
- For discounting postemployment obligations, IAS 19 requires entities to apply a discount rate based on yields on high quality corporate bonds consistent with the currency and estimated term of the postemployment benefit obligations. The requirement in IPSAS 25 is that entities apply a rate that reflects the time value of money. IPSAS 25 also contains a requirement that entities disclose the basis on which the discount rate has been determined.
- IPSAS 25 includes a rebuttable presumption that long-term disability payments are not usually subject to the same degree of uncertainty as the measurement of postemployment benefits. Where this presumption is rebutted the entity considers whether some or all long-term disability payments should be accounted for in the same way as for postemployment benefits. IAS 19 does not include such a rebuttable presumption.
- IPSAS 25 requires entities to determine an initial liability for defined benefit plans on first adoption. If this liability is more or less than the liability that would have been recognized at the same date under the entity's previous accounting policy, the entity is required to recognize that increase/decrease in opening accumulated surpluses or deficits. IAS 19 requires entities to determine a transitional liability for defined benefit plans and, if that amount is more than the amount that would have been recognized under the previous accounting policy, entities are permitted to recognize the increase over a period up to five years from the date of adoption.
- IPSAS 25 uses different terminology, in certain instances, from IAS 19. The most significant examples are the use of the terms revenue, statement of financial performance, and statement of financial position. The equivalent terms in IAS 19 are income, income statement and balance sheet.

IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS

Acknowledgment

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

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IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS

CONTENTS

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

Introduction

IN1. The Standard provides requirements for the identification of assets that may be impaired, the impairment testing of cash-generating assets and cash-generating units and the accounting for impairment losses and the reversal of those losses. It is based on IAS 36, “Impairment of Assets.”

IN2. A cash-generating asset is an asset held with the primary objective of generating a commercial return. The Standard does not deal with the impairment of non-cash-generating assets. Requirements for impairment testing, the accounting for impairment losses and the reversal of those losses for non-cash-generating assets are provided in IPSAS 21, “Impairment of Non-Cash-Generating Assets.” The Standard and IPSAS 21 require entities to disclose the criteria developed to distinguish cash-generating assets and non-cash-generating assets.

IN3. There are a number of scope exclusions. In particular, property, plant and equipment carried on the revaluation model in IPSAS 17, “Property, Plant and Equipment,” intangible assets that are regularly revalued to fair value and goodwill are outside the scope of the Standard.

IN4. The Standard defines an “impairment” as a loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset’s future economic benefits or service potential through depreciation. An asset is impaired when its carrying amount exceeds its recoverable amount.

IN5. With the exception of intangible assets with an indefinite useful life or intangible assets that are not yet available for use, the Standard requires an entity to assess at each reporting date whether there is any indication that an asset may be impaired. In assessing whether there is an indication of impairment the Standard requires an entity to consider, as a minimum, a number of specified indications. The list of indications is not exhaustive and there may be other indications of impairment apart from those listed. Where there is an indication of impairment, an entity determines the recoverable amount of an asset. Intangible assets with an indefinite useful life or intangible assets that are not yet available for use must be tested for impairment annually.

IN6. Recoverable amount is the higher of an asset’s fair value less costs to sell and its value in use. Where there is no reason to believe that an asset’s value in use materially exceeds its fair value less costs to sell, the asset’s fair value less costs to sell may be used as its recoverable amount.

IN7. The estimation of value in use involves the estimation of the future cash flows derived from continuing use of the asset and from its ultimate disposal and the application of an appropriate discount rate to those cash flows. The discount rate is a pre-tax rate that reflects current market assessments of the time value of money and the risks specific to the asset for which the future cash flow estimates have not been adjusted.

IN8. Where the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset is reduced to its recoverable amount. The amount of that reduction is an impairment loss and is recognized immediately in the statement of financial performance.

IN9. There are occasions when the recoverable amount of an individual asset cannot be determined. This is the case where:

(a) The asset's value in use cannot be estimated to be close to its fair value less costs to sell (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and

(b) The asset does not generate cash inflows that are largely independent of those from other assets.

In such cases, value in use and, therefore, recoverable amount, can be determined only for the asset's cash-generating unit. A cash-generating unit is the smallest group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Cash-generating units are identified consistently from reporting period to reporting period, unless a change is justified. Where such a change is made, an entity is required to make disclosures related to the aggregation of assets and the reasons for the change.

IN10. An impairment loss is recognized for a cash-generating unit where the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss is allocated to reduce the carrying amount of the assets of the unit on a pro rata basis, based on the carrying amount of each asset in the unit. However, in making such an allocation, an entity does not reduce the carrying amount of an asset below the highest of:

(a) Its fair value less costs to sell (if determinable);

(b) Its value in use (if determinable); and

(c) Zero.

IN11. Non-cash-generating assets may contribute service potential to cash-generating units. In such cases, a proportion of the carrying amount of that non-cash generating asset is allocated to the carrying amount of the cash-generating unit prior to estimation of the recoverable amount of that cash-generating unit. The carrying amount of the non-cash-generating asset reflects any impairment losses at the reporting date which have been determined under the requirements of IPSAS 21. The allocation of any impairment loss for the cash-generating unit is then made on a pro rata basis to the cash-generating assets in the cash-generating unit. The non-cash-generating asset is not subject to a further impairment loss beyond that which has been determined in accordance with IPSAS 21.

IN12. An entity is required to assess at each reporting date whether there is any indication that an impairment loss recognised in a prior reporting period for an individual asset or a cash-generating unit may no longer exist or may have decreased. In making this assessment, the Standard requires an entity to consider, as a minimum, a number of specified indications. These indications mirror those for identification of a potential impairment loss.

IN13. Where an asset's recoverable amount has increased since the last impairment loss was recognized, and there has been a change in the estimates used to determine the asset's recoverable amount since that impairment loss, there is a reversal of that impairment loss and the carrying amount of the asset is increased to its recoverable amount. The increased carrying amount of the asset is limited to the carrying amount that would have determined (net of amortization or depreciation) had no impairment loss been recognized in prior years. The amount of the reversal is recognized immediately in the statement of financial performance. Requirements for reversing the impairment losses of cash-generating units follow a similar process as for individual assets. The amount of the reversal is allocated to the assets of the cash-generating unit pro rata with the carrying amounts of those assets. No part of the amount of that reversal is allocated to a non-cash-generating asset that contributes service potential to a cash-generating unit.

IN14. A redesignation of an asset from a cash-generating asset to a non-cash-generating asset, or from a non-cash-generating asset to a cash-generating asset, is only made when there is clear evidence that such a redesignation is appropriate. At the subsequent reporting date after a redesignation, an entity reviews, as a minimum, the listed indications applicable to the asset after redesignation.

IPSAS 26—IMPAIRMENT OF CASH-GENERATING ASSETS

Objective

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

Scope

2. **An entity which prepares and presents financial statements under the accrual basis of accounting shall apply this Standard in accounting for the impairment of cash-generating assets, except for:**

   (a) **Inventories (see IPSAS 12, "Inventories");**

   (b) **Assets arising from construction contracts (see IPSAS 11, "Construction Contracts");**

   (c) **Financial assets that are within the scope of IPSAS 15, "Financial Instruments: Disclosure and Presentation";**

   (d) **Investment property that is measured at fair value (see IPSAS 16, "Investment Property");**

   (e) **Cash-generating property, plant and equipment that is measured at revalued amounts (see IPSAS 17, "Property, Plant and Equipment");**

   (f) **Deferred tax assets (see the relevant international or national accounting standard dealing with deferred tax assets);**

   (g) **Assets arising from employee benefits (see IPSAS 25, "Employee Benefits");**

   (h) **Intangible assets that are regularly revalued to fair value;**

   (i) **Goodwill;**

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

   (k) **Deferred acquisition costs, and intangible assets, arising from an insurer's contractual rights under insurance contracts within the scope of the relevant international or national accounting standard dealing with insurance contracts;**

   (l) **Non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value**

less costs to sell in accordance with the relevant international or national accounting standard dealing with non-current assets held for sale and discontinued operations; and

(m) **Other cash-generating assets in respect of which accounting requirements for impairment are included in another International Public Sector Accounting Standard.**

3. **This Standard applies to all public sector entities other than Government Business Enterprises (GBEs).**

4. GBEs apply IAS 36, "Impairment of Assets" and therefore are not subject to the provisions of this Standard. Public sector entities, other than GBEs, that hold non-cash-generating assets as defined in paragraph 13 apply IPSAS 21, "Impairment of Non-Cash-Generating Assets" to such assets. Public sector entities, other than GBEs, that hold cash-generating assets apply the requirements of this Standard.

5. This Standard excludes cash-generating intangible assets that are regularly revalued to fair value from its scope. This Standard includes all other cash-generating intangible assets (for example, those that are carried at cost less any accumulated amortization) within its scope.

6. This Standard excludes goodwill from its scope. Entities apply the requirements of the relevant international or national accounting standards dealing with the impairment of goodwill, the allocation of goodwill to cash-generating units and the testing for impairment of cash-generating units with goodwill.

7. This Standard does not apply to inventories and cash-generating assets arising from construction contracts, because existing Standards applicable to these assets contain requirements for recognizing and measuring such assets. This Standard does not apply to deferred tax assets, assets related to employee benefits, or deferred acquisition costs and intangible assets arising from an insurer's contractual rights under insurance contracts. The impairment of such assets is addressed in the relevant international or national accounting standards. In addition, this Standard does not apply to biological assets related to agricultural activity that are measured at fair value less certain point-of-sale costs and non-current assets (or disposal groups) classified as held for sale that are measured at the lower of carrying amount and fair value less costs to sell. The relevant international or national accounting standards dealing with such assets contain measurement requirements.

8. This Standard does not apply to any financial assets that are included in the scope of IPSAS 15. Impairment of these assets will be dealt with in any IPSAS that the IPSASB develops to deal with the recognition and measurement of financial instruments.

9. This Standard does not require the application of an impairment test to an investment property that is carried at fair value in accordance with IPSAS 16.

Under the fair value model in IPSAS 16, an investment property is carried at fair value at the reporting date and any impairment will be taken into account in the valuation.

10. This Standard does not require the application of an impairment test to cash-generating assets that are carried at revalued amounts under the revaluation model in IPSAS 17. Under the revaluation model in IPSAS 17, assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date and any impairment will be taken into account in that valuation.

11. Investments in:

    (a) Controlled entities, as defined in IPSAS 6, "Consolidated and Separate Financial Statements";

    (b) Associates, as defined in IPSAS 7, "Investments in Associates"; and

    (c) Joint ventures, as defined in IPSAS 8, "Interests in Joint Ventures"

    are financial assets that are excluded from the scope of IPSAS 15. Where such investments are in the nature of cash-generating assets, they are dealt with under this Standard. Where these assets are in the nature of non-cash-generating assets, they are dealt with under IPSAS 21.

12. The "Preface to International Public Sector Accounting Standards" issued by the IPSASB explains that International Financial Reporting Standards (IFRSs) are designed to apply to the general purpose financial statements of all profit-oriented entities. GBEs are profit-oriented entities and accordingly are required to comply with IFRSs.

Definitions

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

    <u>Cash-generating assets</u> are assets held with the primary objective of generating a commercial return.

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

    An <u>impairment loss of a cash-generating asset</u> is the amount by which the carrying amount of an asset exceeds its recoverable amount.

    <u>Non-cash-generating assets</u> are assets other than cash-generating assets.

    The <u>recoverable amount</u> of an asset or a cash-generating unit is the higher of its fair value less costs to sell and its value in use.

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

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

Cash-Generating Assets

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

15. There are a number of circumstances in which public sector entities may hold some assets with the primary objective of generating a commercial return, although the majority of their assets are not held for that purpose. For example, a hospital may deploy a building for fee-paying patients. Cash-generating assets of a public sector entity may operate independently of the non-cash-generating assets of the entity. For example, the deeds office may earn land registration fees independently from the department of land affairs.

16. In certain instances, an asset may generate cash flows although it is primarily held for service delivery purposes. For example, a waste disposal plant is operated to ensure the safe disposal of medical waste generated by state controlled hospitals, but the plant also treats a small amount of medical waste generated by other private hospitals on a commercial basis. The treatment of medical waste from the private hospitals is incidental to the activities of the plant, and the assets that generate cash flows cannot be distinguished from the non-cash-generating assets.

17. In other instances an asset may generate cash flows and also be used for non-cash-generating purposes. For example, a public hospital has ten wards, nine of which are used for fee-paying patients on a commercial basis, and the other is used for non-fee-paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the

asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 21. If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies this Standard, rather than IPSAS 21.

18. In some cases it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases it is necessary to evaluate the significance of the cash flows. It may be difficult to determine whether the extent to which the asset generates cash flows is so significant that this Standard is applicable, rather than IPSAS 21. Judgment is needed to determine which Standard to apply. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets and with the related guidance in paragraphs 14-17. Paragraph 114 requires an entity to disclose the criteria used in making this judgment. However, given the overall objectives of most public sector entities other than GBEs, the presumption is that assets are non-cash-generating in these circumstances and, therefore, IPSAS 21 will apply.

Depreciation

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

Impairment

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

Identifying an Asset that may be Impaired

21. An asset is impaired when its carrying amount exceeds its recoverable amount. Paragraphs 25–27 describe some indications that an impairment loss may have occurred. If any of those indications is present, an entity is required to make a formal estimate of recoverable amount. Except for the

circumstances described in paragraph 23, this Standard does not require an entity to make a formal estimate of recoverable amount if no indication of an impairment loss is present.

22. **An entity shall assess at each reporting date whether there is any indication that an asset may be impaired. If any such indication exists, the entity shall estimate the recoverable amount of the asset**.

23. **Irrespective of whether there is any indication of impairment, an entity shall also test an intangible asset with an indefinite useful life or an intangible asset not yet available for use for impairment annually by comparing its carrying amount with its recoverable amount. This impairment test may be performed at any time during the reporting period, provided it is performed at the same time every year. Different intangible assets may be tested for impairment at different times. However, if such an intangible asset was initially recognized during the current reporting period, that intangible asset shall be tested for impairment before the end of the current reporting period.**

24. The ability of an intangible asset to generate sufficient future economic benefits or service potential to recover its carrying amount is usually subject to greater uncertainty before the asset is available for use than after it is available for use. Therefore, this Standard requires an entity to test for impairment, at least annually, the carrying amount of an intangible asset that is not yet available for use.

25. **In assessing whether there is any indication that an asset may be impaired, an entity shall consider, as a minimum, the following indications**:

<u>**External sources of information**</u>

(a) **During the period, an asset's market value has declined significantly more than would be expected as a result of the passage of time or normal use;**

(b) **Significant changes with an adverse effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which an asset is dedicated;**

(c) **Market interest rates or other market rates of return on investments have increased during the period, and those increases are likely to affect the discount rate used in calculating an asset's value in use and decrease the asset's recoverable amount materially;**

<u>**Internal sources of information**</u>

(d) **Evidence is available of obsolescence or physical damage of an asset;**

(e) **Significant changes with an adverse effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or 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; and**

(f) Evidence is available from internal reporting that indicates that the economic performance of an asset is, or will be, worse than expected.

26. The list in paragraph 25 is not exhaustive. An entity may identify other indications that an asset may be impaired and these would also require the entity to determine the asset's recoverable amount.

27. Evidence from internal reporting that indicates that an asset may be impaired includes the existence of:

(a) Cash flows for acquiring the asset, or subsequent cash needs for operating or maintaining it, that are significantly higher than those originally budgeted;

(b) Actual net cash flows or net surplus or deficit flowing from the asset that are significantly worse than those budgeted;

(c) A significant decline in budgeted net cash flows or surplus or a significant increase in budgeted loss, flowing from the asset; or

(d) Deficits or net cash outflows for the asset, when current period amounts are aggregated with budgeted amounts for the future.

28. As indicated in paragraph 23, this Standard requires an intangible asset with an indefinite useful life or an intangible asset that is not yet available for use to be tested for impairment, at least annually. Apart from when the requirements in paragraph 23 apply, the concept of materiality applies in identifying whether the recoverable amount of an asset needs to be estimated. For example, if previous calculations show that an asset's recoverable amount is significantly greater than its carrying amount, the entity need not re-estimate the asset's recoverable amount if no events have occurred that would eliminate that difference. Similarly, previous analysis may show that an asset's recoverable amount is not sensitive to one (or more) of the indications listed in paragraph 25.

29. As an illustration of paragraph 28, if market interest rates or other market rates of return on investments have increased during the period, an entity is not required to make a formal estimate of an asset's recoverable amount in the following cases:

(a) If the discount rate used in calculating the asset's value in use is unlikely to be affected by the increase in these market rates. For example, increases in short-term interest rates may not have a material effect on the discount rate used for an asset that has a long remaining useful life.

(b) If the discount rate used in calculating the asset's value in use is likely to be affected by the increase in these market rates but previous sensitivity analysis of recoverable amount shows that:

(i) It is unlikely that there will be a material decrease in recoverable amount because future cash flows are also likely to increase (for example, in some cases, an entity may be able to demonstrate that it adjusts its revenues (mainly exchange revenues) to compensate for any increase in market rates); or

(ii) The decrease in recoverable amount is unlikely to result in a material impairment loss.

30. If there is an indication that an asset may be impaired, this may indicate that the remaining useful life, the depreciation (amortization) method or the residual value for the asset needs to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is recognized for the asset.

Measuring Recoverable Amount

31. This Standard defines recoverable amount as the higher of an asset's fair value less costs to sell and its value in use. Paragraphs 32–70 set out the requirements for measuring recoverable amount. These requirements use the term "an asset" but apply equally to an individual asset or a cash-generating unit.

32. It is not always necessary to determine both an asset's fair value less costs to sell and its value in use. If either of these amounts exceeds the asset's carrying amount, the asset is not impaired and it is not necessary to estimate the other amount.

33. It may be possible to determine fair value less costs to sell, even if an asset is not traded in an active market. However, sometimes it will not be possible to determine fair value less costs to sell because there is no basis for making a reliable estimate of the amount obtainable from the sale of the asset in an arm's length transaction between knowledgeable and willing parties. In this case, the entity may use the asset's value in use as its recoverable amount.

34. If there is no reason to believe that an asset's value in use materially exceeds its fair value less costs to sell, the asset's fair value less costs to sell may be used as its recoverable amount. This will often be the case for an asset that is held for disposal. This is because the value in use of an asset held for disposal will consist mainly of the net disposal proceeds, as the future cash flows from continuing use of the asset until its disposal are likely to be negligible.

35. Recoverable amount is determined for an individual asset, unless the asset does not generate cash inflows that are largely independent of those from other assets or groups of assets. If this is the case, recoverable amount is determined for the cash-generating unit to which the asset belongs (see paragraphs 85–90), unless either:

    (a) The asset's fair value less costs to sell is higher than its carrying amount; or

    (b) The asset is a part of a cash-generating unit but is capable of generating cash flows individually, the asset's value in use can be estimated to be close to its fair value less costs to sell and the asset's fair value less costs to sell can be determined.

36. In some cases, estimates, averages and computational short cuts may provide reasonable approximations of the detailed computations for determining fair value less costs to sell or value in use.

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

37. Paragraph 23 requires an intangible asset with an indefinite useful life to be tested for impairment annually by comparing its carrying amount with its recoverable amount, irrespective of whether there is any indication that it may be impaired. However, the most recent detailed calculation of such an asset's recoverable amount made in a preceding period may be used in the impairment test for that asset in the current period, provided all of the following criteria are met:

    (a) If the intangible asset does not generate cash inflows from continuing use that are largely independent of those from other assets or groups of assets and is therefore tested for impairment as part of the cash-generating unit to which it belongs, the assets and liabilities making up that unit have not changed significantly since the most recent recoverable amount calculation;

    (b) The most recent recoverable amount calculation resulted in an amount that exceeded the asset's carrying amount by a substantial margin; and

    (c) Based on an analysis of events that have occurred and circumstances that have changed since the most recent recoverable amount calculation, the likelihood that a current recoverable amount determination would be less than the asset's carrying amount is remote.

Fair Value less Costs to Sell

38. The best evidence of an asset's fair value less costs to sell is 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.

39. If there is no binding sale agreement but an asset is traded in an active market, fair value less costs to sell is the asset's market price less the costs of disposal. The appropriate market price is usually the current bid price. When current bid prices are unavailable, the price of the most recent transaction may provide a basis from which to estimate fair value less costs to sell, provided that there has not been a significant change in economic circumstances between the transaction date and the date as at which the estimate is made.

40. If there is no binding sale agreement or active market for an asset, fair value less costs to sell is based on the best information available to reflect the amount that an entity could obtain, at the reporting date, from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the costs of disposal. In determining this amount, an entity considers the outcome of recent transactions for similar assets within the same industry. Fair value less costs to sell does not reflect a forced sale.

41. Costs of disposal, other than those that have been recognized as liabilities, are deducted in determining fair value less costs to sell. Examples of such costs are legal costs, stamp duty and similar transaction taxes, costs of removing the asset, and direct incremental costs to bring an asset into condition for its sale. However, termination benefits and costs associated with reducing or reorganizing a business following the disposal of an asset are not direct incremental costs to dispose of the asset.

42. Sometimes, the disposal of an asset would require the buyer to assume a liability and only a single fair value less costs to sell is available for both the asset and the liability. Paragraph 89 explains how to deal with such cases.

Value in Use

43. **The following elements shall be reflected in the calculation of an asset's value in use:**

    (a) **An estimate of the future cash flows the entity expects to derive from the asset;**

    (b) **Expectations about possible variations in the amount or timing of those future cash flows;**

    (c) **The time value of money, represented by the current market risk-free rate of interest;**

    (d) **The price for bearing the uncertainty inherent in the asset; and**

    (e) **Other factors, such as illiquidity, that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.**

44. Estimating the value in use of an asset involves the following steps:

(a) Estimating the future cash inflows and outflows to be derived from continuing use of the asset and from its ultimate disposal; and

(b) Applying the appropriate discount rate to those future cash flows.

45. The elements identified in paragraph 43(b), (d) and (e) can be reflected either as adjustments to the future cash flows or as adjustments to the discount rate. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result shall be to reflect the expected present value of the future cash flows, i.e., the weighted average of all possible outcomes. Appendix A provides additional guidance on the use of present value techniques in measuring an asset's value in use.

Basis for Estimates of Future Cash Flows

46. **In measuring value in use an entity shall:**

(a) Base cash flow projections on reasonable and supportable assumptions that represent management's best estimate of the range of economic conditions that will exist over the remaining useful life of the asset. Greater weight shall be given to external evidence;

(b) Base cash flow projections on the most recent financial budgets/forecasts approved by management, but shall exclude any estimated future cash inflows or outflows expected to arise from future restructurings or from improving or enhancing the asset's performance. Projections based on these budgets/forecasts shall cover a maximum period of five years, unless a longer period can be justified; and

(c) **Estimate cash flow projections beyond the period covered by the most recent budgets/forecasts by extrapolating the projections based on the budgets/forecasts using a steady or declining growth rate for subsequent years, unless an increasing rate can be justified. This growth rate shall not exceed the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used, unless a higher rate can be justified.**

47. Management assesses the reasonableness of the assumptions on which its current cash flow projections are based by examining the causes of differences between past cash flow projections and actual cash flows. Management shall ensure that the assumptions on which its current cash flow projections are based are consistent with past actual outcomes, provided the effects of subsequent events or circumstances that did not exist when those actual cash flows were generated make this appropriate.

48. Detailed, explicit and reliable financial budgets/forecasts of future cash flows for periods longer than five years are generally not available. For this reason,

management's estimates of future cash flows are based on the most recent budgets/forecasts for a maximum of five years. Management may use cash flow projections based on financial budgets/forecasts over a period longer than five years if it is confident that these projections are reliable and it can demonstrate its ability, based on past experience, to forecast cash flows accurately over that longer period.

49. Cash flow projections until the end of an asset's useful life are estimated by extrapolating the cash flow projections based on the financial budgets/forecasts using a growth rate for subsequent years. This rate is steady or declining, unless an increase in the rate matches objective information about patterns over a product or industry lifecycle. If appropriate, the growth rate is zero or negative.

50. When conditions are favorable, competitors may enter the market and restrict growth. Therefore, entities will have difficulty in exceeding the average historical growth rate over the long term (say, twenty years) for the products, industries, or country or countries in which the entity operates, or for the market in which the asset is used.

51. In using information from financial budgets/forecasts, an entity considers whether the information reflects reasonable and supportable assumptions and represents management's best estimate of the set of economic conditions that will exist over the remaining useful life of the asset.

Composition of Estimates of Future Cash Flows

52. **Estimates of future cash flows shall include:**

(a) **Projections of cash inflows from the continuing use of the asset;**

(b) **Projections of cash outflows that are necessarily incurred to generate the cash inflows from continuing use of the asset (including cash outflows to prepare the asset for use) and can be directly attributed, or allocated on a reasonable and consistent basis, to the asset; and**

(c) **Net cash flows, if any, to be received (or paid) for the disposal of the asset at the end of its useful life.**

53. Estimates of future cash flows and the discount rate reflect consistent assumptions about price increases attributable to general inflation. Therefore, if the discount rate includes the effect of price increases attributable to general inflation, future cash flows are estimated in nominal terms. If the discount rate excludes the effect of price increases attributable to general inflation, future cash flows are estimated in real terms (but include future specific price increases or decreases).

54. Projections of cash outflows include those for the day-to-day servicing of the asset as well as future overheads that can be attributed directly, or allocated on a reasonable and consistent basis, to the use of the asset.

55. When the carrying amount of an asset does not yet include all the cash outflows to be incurred before it is ready for use or sale, the estimate of future cash outflows includes an estimate of any further cash outflow that is expected to be incurred before the asset is ready for use or sale. For example, this is the case for a building under construction or for a development project that is not yet completed.

56. To avoid double-counting, estimates of future cash flows do not include:

(a) Cash inflows from assets that generate cash inflows that are largely independent of the cash inflows from the asset under review (for example, financial assets such as receivables); and

(b) Cash outflows that relate to obligations that have been recognized as liabilities (for example, payables, pensions or provisions).

57. **Future cash flows shall be estimated for the asset in its current condition. Estimates of future cash flows shall not include estimated future cash inflows or outflows that are expected to arise from:**

(a) **A future restructuring to which an entity is not yet committed; or**

(b) **Improving or enhancing the asset's performance.**

58. Because future cash flows are estimated for the asset in its current condition, value in use does not reflect:

(a) Future cash outflows or related cost savings (for example, reductions in staff costs) or benefits that are expected to arise from a future restructuring to which an entity is not yet committed; or

(b) Future cash outflows that will improve or enhance the asset's performance or the related cash inflows that are expected to arise from such outflows.

59. A restructuring is a program that is planned and controlled by management and materially changes either the scope of the entity's activities or the manner in which those activities are carried out. IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets" contains guidance clarifying when an entity is committed to a restructuring.

60. When an entity becomes committed to a restructuring, some assets are likely to be affected by this restructuring. Once the entity is committed to the restructuring:

(a) Its estimates of future cash inflows and cash outflows for the purpose of determining value in use reflect the cost savings and other benefits from the restructuring (based on the most recent financial budgets/forecasts approved by management); and

(b) Its estimates of future cash outflows for the restructuring are included in a restructuring provision in accordance with IPSAS 19.

61. Until an entity incurs cash outflows that improve or enhance the asset's performance, estimates of future cash flows do not include the estimated future cash inflows that are expected to arise from the increase in economic benefits or service potential associated with the expected cash outflow.

62. Estimates of future cash flows include future cash outflows necessary to maintain the level of economic benefits or service potential expected to arise from the asset in its current condition. When a unit consists of assets with different estimated useful lives, all of which are essential to the ongoing operation of the unit, the replacement of assets with shorter lives is considered to be part of the day-to-day servicing of the unit when estimating the future cash flows associated with the unit. Similarly, when a single asset consists of components with different estimated useful lives, the replacement of components with shorter lives is considered to be part of the day-to-day servicing of the asset when estimating the future cash flows generated by the asset.

63. **Estimates of future cash flows shall not include:**

(a) Cash inflows or outflows from financing activities; or

(b) Income tax receipts or payments.

64. Estimated future cash flows reflect assumptions that are consistent with the way the discount rate is determined. Otherwise, the effect of some assumptions will be counted twice or ignored. Because the time value of money is considered by discounting the estimated future cash flows, these cash flows exclude cash inflows or outflows from financing activities. Similarly, since the discount rate is determined on a pre-tax basis, future cash flows are also determined on a pre-tax basis.

65. **The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life shall be the amount that an entity expects to obtain from the disposal of the asset in an arm's length transaction between knowledgeable, willing parties, after deducting the estimated costs of disposal.**

66. The estimate of net cash flows to be received (or paid) for the disposal of an asset at the end of its useful life is determined in a similar way to an asset's fair value less costs to sell, except that, in estimating those net cash flows:

(a) An entity uses prices prevailing at the date of the estimate for similar assets that have reached the end of their useful life and have operated under conditions similar to those in which the asset will be used; and

(b) The entity adjusts those prices for the effect of both future price increases due to general inflation and specific future price increases or decreases. However, if estimates of future cash flows from the asset's continuing use and the discount rate exclude the effect of general inflation, the entity also excludes this effect from the estimate of net cash flows on disposal.

Foreign Currency Future Cash Flows

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

Discount Rate

68. **The discount rate (rates) shall be a pre-tax rate (rates) that reflect(s) current market assessments of:**

    (a) **The time value of money, represented by the current risk-free rate of interest; and**

    (b) **The risks specific to the asset for which the future cash flow estimates have not been adjusted.**

69. A rate that reflects current market assessments of the time value of money and the risks specific to the asset is the return that investors would require if they were to choose an investment that would generate cash flows of amounts, timing and risk profile equivalent to those that the entity expects to derive from the asset. This rate is estimated from the rate implicit in current market transactions for similar assets. However, the discount rate(s) used to measure an asset's value in use shall not reflect risks for which the future cash flow estimates have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

70. When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. Appendix A provides additional guidance on estimating the discount rate in such circumstances.

Recognizing and Measuring an Impairment Loss of an Individual Asset

71. Paragraphs 72–75 set out the requirements for recognizing and measuring impairment losses for an individual asset. The recognition and measurement of impairment losses for cash-generating units are dealt with in paragraphs 76–97.

72. **If, and only if, the recoverable amount of an asset is less than its carrying amount, the carrying amount of the asset shall be reduced to its recoverable amount. That reduction is an impairment loss.**

73. **An impairment loss shall be recognized immediately in surplus or deficit**.

74. **When the amount estimated for an impairment loss is greater than the carrying amount of the asset to which it relates, an entity shall recognize a liability if, and only if, that is required by another Standard.**

75. **After the recognition of an impairment loss, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Cash-Generating Units

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

Identifying the Cash-Generating Unit to which an Asset Belongs

77. **If there is any indication that an asset may be impaired, the recoverable amount shall be estimated for the individual asset. If it is not possible to estimate the recoverable amount of the individual asset, an entity shall determine the recoverable amount of the cash-generating unit to which the asset belongs (the asset's cash-generating unit).**

78. The recoverable amount of an individual asset cannot be determined if:

    (a) The asset's value in use cannot be estimated to be close to its fair value less costs to sell (for example, when the future cash flows from continuing use of the asset cannot be estimated to be negligible); and

    (b) The asset does not generate cash inflows that are largely independent of those from other assets and is not capable of generating cash flows individually.

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

79. As defined in paragraph 13, an asset's cash-generating unit is the smallest group of assets that includes the asset and generates cash inflows that are largely independent of the cash inflows from other assets or groups of assets. Identification of an asset's cash-generating unit involves judgment. If recoverable amount cannot be determined for an individual asset, an entity identifies the lowest aggregation of assets that generate largely independent cash inflows.

80 Cash inflows are inflows of cash and cash equivalents received from parties external to the entity. In identifying whether cash inflows from an asset (or group of assets) are largely independent of the cash inflows from other assets (or groups of assets), an entity considers various factors including how management monitors the entity's operations (such as by product lines, businesses, individual locations, districts or regional areas) or how management makes decisions about continuing or disposing of the entity's assets and operations. [Illustrative Example 1 in the Implementation Guidance gives an example of the identification of a cash-generating unit.]

81. **If an active market exists for the output produced by an asset or group of assets, that asset or group of assets shall be identified as a cash-generating unit, even if some or all of the output is used internally. If the cash inflows generated by any asset or cash-generating unit are affected by internal transfer pricing, an entity shall use management's best estimate of future price(s) that could be achieved in arm's length transactions in estimating:**

(a) **The future cash inflows used to determine the asset's or cash-generating unit's value in use; and**

(b) **The future cash outflows used to determine the value in use of any other assets or cash-generating units that are affected by the internal transfer pricing.**

82. Even if part or all of the output produced by an asset or a group of assets is used by other units of the entity (for example, products at an intermediate stage of a production process), this asset or group of assets forms a separate cash-generating unit if the entity could sell the output on an active market. This is because the asset or group of assets could generate cash inflows that would be largely independent of the cash inflows from other assets or groups of assets. In using information based on financial budgets/forecasts that relates to such a cash-generating unit, or to any other asset or cash-generating unit affected by internal transfer pricing, an entity adjusts this information if internal transfer prices do not reflect management's best estimate of future prices that could be achieved in arm's length transactions.

83. **Cash-generating units shall be identified consistently from period to period for the same asset or types of assets, unless a change is justified.**

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

Recoverable Amount and Carrying Amount of a Cash-Generating Unit

85. The recoverable amount of a cash-generating unit is the higher of the cash-generating unit's fair value less costs to sell and its value in use. For the purpose of determining the recoverable amount of a cash-generating unit, any reference in paragraphs 31–70 to an asset is read as a reference to a cash-generating unit.

86. **The carrying amount of a cash-generating unit shall be determined on a basis consistent with the way the recoverable amount of the cash-generating unit is determined.**

87. The carrying amount of a cash-generating unit:

    (a) Includes the carrying amount of only those assets that can be attributed directly, or allocated on a reasonable and consistent basis, to the cash-generating unit and will generate the future cash inflows used in determining the cash-generating unit's value in use; and

    (b) Does not include the carrying amount of any recognized liability, unless the recoverable amount of the cash-generating unit cannot be determined without consideration of this liability.

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

88. When assets are grouped for recoverability assessments, it is important to include in the cash-generating unit all assets that generate or are used to generate the relevant stream of cash inflows. Otherwise, the cash-generating unit may appear to be fully recoverable when in fact an impairment loss has occurred. Appendix B provides a flow diagram illustrating the treatment of individual assets that are part of cash-generating units.

89. It may be necessary to consider some recognized liabilities to determine the recoverable amount of a cash-generating unit. This may occur if the disposal of a cash-generating unit would require the buyer to assume the liability. In this case, the fair value less costs to sell (or the estimated cash flow from ultimate disposal) of the cash-generating unit is the estimated selling price for the assets of the cash-generating unit and the liability together, less the costs of disposal. To perform a meaningful comparison between the carrying amount of the cash-generating unit and its recoverable amount, the carrying amount of the liability is deducted in determining both the cash-generating unit's value in use and its carrying amount.

90. For practical reasons, the recoverable amount of a cash-generating unit is sometimes determined after consideration of assets that are not part of the cash-generating unit (for example, receivables or other financial assets) or liabilities

that have been recognized (for example, payables, pensions and other provisions). In such cases, the carrying amount of the cash-generating unit is increased by the carrying amount of those assets and decreased by the carrying amount of those liabilities.

Impairment Loss for a Cash-Generating Unit

91. **An impairment loss shall be recognized for a cash-generating unit if, and only if, the recoverable amount of the unit is less than the carrying amount of the unit. The impairment loss shall be allocated to reduce the carrying amount of the cash-generating assets of the unit on a pro rata basis, based on the carrying amount of each asset in the unit. These reductions in carrying amounts shall be treated as impairment losses on individual assets and recognized in accordance with paragraph 73.**

92. **In allocating an impairment loss in accordance with paragraph 91, an entity shall not reduce the carrying amount of an asset below the highest of:**

    (a) **Its fair value less costs to sell (if determinable);**

    (b) **Its value in use (if determinable); and**

    (c) **Zero.**

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

93. **Where a non-cash-generating asset contributes to a cash-generating unit, a proportion of the carrying amount of that non-cash-generating asset shall be allocated to the carrying amount of the cash-generating unit prior to estimation of the recoverable amount of the cash-generating unit. The carrying amount of the non-cash-generating asset shall reflect any impairment losses at the reporting date which have been determined under the requirements of IPSAS 21.**

94. If the recoverable amount of an individual asset cannot be determined (see paragraph 78):

    (a) An impairment loss is recognized for the asset if its carrying amount is greater than the higher of its fair value less costs to sell and the results of the allocation procedures described in paragraphs 91−93; and

    (b) No impairment loss is recognized for the asset if the related cash-generating unit is not impaired. This applies even if the asset's fair value less costs to sell is less than its carrying amount.

95. In some cases, non-cash-generating assets contribute to cash-generating units. This Standard requires that, where a cash-generating unit subject to an impairment test contains a non-cash-generating asset, that non-cash-

generating asset is tested for impairment in accordance with the requirements of IPSAS 21. A proportion of the carrying amount of that non-cash-generating asset, following that impairment test, is included in the carrying amount of the cash-generating unit. The proportion reflects the extent to which the service potential of the non-cash-generating asset contributes to the cash-generating unit. The allocation of any impairment loss for the cash-generating unit is then made on a pro rata basis to all cash-generating assets in the cash-generating unit, subject to the limits in paragraph 92. The non-cash-generating asset is not subject to a further impairment loss beyond that which has been determined in accordance with IPSAS 21.

96. Where an asset releases service potential to one or more cash-generating activities, but not to non-cash-generating activities, entities refer to the relevant international and national accounting standard dealing with such circumstances.

97. **After the requirements in paragraphs 91−93 have been applied, a liability shall be recognized for any remaining amount of an impairment loss for a cash-generating unit if, and only if, that is required by another Standard.**

Reversing an Impairment Loss

98. Paragraphs 99–105 set out the requirements for reversing an impairment loss recognized for an asset or a cash-generating unit in prior periods. These requirements use the term “an asset” but apply equally to an individual asset or a cash-generating unit. Additional requirements for an individual asset are set out in paragraphs 106–109 and for a cash-generating unit in paragraphs 110 and 111.

99. **An entity shall assess at each reporting date whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased. If any such indication exists, the entity shall estimate the recoverable amount of that asset.**

100. **In assessing whether there is any indication that an impairment loss recognized in prior periods for an asset may no longer exist or may have decreased, an entity shall consider, as a minimum, the following indications:**

External sources of information

(a) **The asset’s market value has increased significantly during the period;**

(b) **Significant changes with a favorable effect on the entity have taken place during the period, or will take place in the near future, in the technological, market, economic or legal environment in which the entity operates or in the market to which the asset is dedicated;**

(c) **Market interest rates or other market rates of return on investments have decreased during the period, and those decreases are likely to affect the discount rate used in calculating the asset's value in use and increase the asset's recoverable amount materially;**

Internal sources of information

(d) **Significant changes with a favorable effect on the entity have taken place during the period, or are expected to take place in the near future, in the extent to which, or manner in which, the asset is used or is expected to be used. These changes include costs incurred during the period to improve or enhance the asset's performance or restructure the operation to which the asset belongs; and**

(e) **Evidence is available from internal reporting that indicates that the economic performance of the asset is, or will be, better than expected.**

101. Indications of a potential decrease in an impairment loss in paragraph 100 mainly mirror the indications of a potential impairment loss in paragraph 25.

102. If there is an indication that an impairment loss recognized for an asset may no longer exist or may have decreased, this may indicate that the remaining useful life, the depreciation (amortization) method or the residual value may need to be reviewed and adjusted in accordance with the Standard applicable to the asset, even if no impairment loss is reversed for the asset.

103. **An impairment loss recognized in prior periods for an asset shall be reversed if, and only if, there has been a change in the estimates used to determine the asset's recoverable amount since the last impairment loss was recognized. If this is the case, the carrying amount of the asset shall be increased to its recoverable amount. That increase is a reversal of an impairment loss.**

104. A reversal of an impairment loss reflects an increase in the estimated service potential of an asset, either from use or from sale, since the date when an entity last recognized an impairment loss for that asset. An entity is required to identify the change in estimates that causes the increase in estimated service potential. Examples of changes in estimates include:

(a) A change in the basis for recoverable amount (i.e., whether recoverable amount is based on fair value less costs to sell or value in use);

(b) If recoverable amount was based on value in use, a change in the amount or timing of estimated future cash flows or in the discount rate; or

(c) If recoverable amount was based on fair value less costs to sell, a change in estimate of the components of fair value less costs to sell.

105. An asset's value in use may become greater than the asset's carrying amount simply because the present value of future cash inflows increases as they become closer. However, the service potential of the asset has not increased. Therefore, an impairment loss is not reversed just because of the passage of time (sometimes called the unwinding of the discount), even if the recoverable amount of the asset becomes higher than its carrying amount.

Reversing an Impairment Loss for an Individual Asset

106. **The increased carrying amount of an asset attributable to a reversal of an impairment loss shall not exceed the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years.**

107. Any increase in the carrying amount of an asset above the carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior years is a revaluation. In accounting for such a revaluation, an entity applies the Standard applicable to the asset.

108. **A reversal of an impairment loss for an asset shall be recognized immediately in surplus or deficit**.

109. **After a reversal of an impairment loss is recognized, the depreciation (amortization) charge for the asset shall be adjusted in future periods to allocate the asset's revised carrying amount, less its residual value (if any), on a systematic basis over its remaining useful life.**

Reversing an Impairment Loss for a Cash-Generating Unit

110. **A reversal of an impairment loss for a cash-generating unit shall be allocated to the cash-generating assets of the unit pro rata with the carrying amounts of those assets. These increases in carrying amounts shall be treated as reversals of impairment losses for individual assets and recognized in accordance with paragraph 109. No part of the amount of such a reversal shall be allocated to a non-cash-generating asset contributing service potential to a cash-generating unit.**

111. **In allocating a reversal of an impairment loss for a cash-generating unit in accordance with paragraph 110, the carrying amount of an asset shall not be increased above the lower of:**

(a) **Its recoverable amount (if determinable); and**

(b) **The carrying amount that would have been determined (net of amortization or depreciation) had no impairment loss been recognized for the asset in prior periods.**

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

Redesignation of Assets

112. **The redesignation of an asset from a cash-generating asset to a non-cash-generating asset or from a non-cash-generating asset to a cash-generating asset shall only occur when there is clear evidence that such a redesignation is appropriate. A redesignation, by itself, does not necessarily trigger an impairment test or a reversal of an impairment loss. At the subsequent reporting date after a redesignation, an entity shall consider, as a minimum, the listed indications in paragraph 25.**

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

Disclosure

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

115. **An entity shall disclose the following for each class of assets:**

   (a) **The amount of impairment losses recognized in surplus or deficit during the period and the line item(s) of the statement of financial performance in which those impairment losses are included.**

   (b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period and the line item(s) of the statement of financial performance in which those impairment losses are reversed.**

116. In some cases it may be not be clear whether the primary objective of holding an asset is to generate a commercial return. That judgment is needed to determine whether to apply this Standard or IPSAS 21. Paragraph 114 requires the disclosure of the criteria used for distinguishing cash-generating and non-cash-generating assets.

117. A class of assets is a grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements.

118. The information required in paragraph 115 may be presented with other information disclosed for the class of assets. For example, this information may be included in a reconciliation of the carrying amount of property, plant and equipment, at the beginning and end of the period, as required by IPSAS 17.

119. **An entity that reports segment information in accordance with IPSAS 18, "Segment Reporting," shall disclose the following for each reported segment based on an entity's reporting format:**

 (a) **The amount of impairment losses recognized in surplus or deficit during the period; and**

 (b) **The amount of reversals of impairment losses recognized in surplus or deficit during the period.**

120. **An entity shall disclose the following for each material impairment loss recognized or reversed during the period for a cash-generating asset or a cash-generating unit:**

 (a) **The events and circumstances that led to the recognition or reversal of the impairment loss;**

 (b) **The amount of the impairment loss recognized or reversed;**

 (c) **For a cash-generating asset:**

  (i) **The nature of the asset; and**

  (ii) **If the entity reports segment information in accordance with IPSAS 18, the reported segment to which the asset belongs, based on the entity's reporting format.**

 (d) **For a cash-generating unit:**

  (i) **A description of the cash-generating unit (such as whether it is a product line, a plant, a business operation, a geographical area, or a reported segment);**

  (ii) **The amount of the impairment loss recognized or reversed by class of assets, and, if the entity reports segment information in accordance with IPSAS 18, by reported segment based on the entity's reporting format; and**

  (iii) **If the aggregation of assets for identifying the cash-generating unit has changed since the previous estimate of the cash-generating unit's recoverable amount (if any), a description of the current and former way of aggregating assets and the reasons for changing the way the cash-generating unit is identified.**

 (e) **Whether the recoverable amount of the asset is its fair value less costs to sell or its value in use;**

(f) **If the recoverable amount is fair value less costs to sell, the basis used to determine fair value less costs to sell (such as whether fair value was determined by reference to an active market); and**

(g) **If the recoverable amount is value in use, the discount rate(s) used in the current estimate and previous estimate (if any) of value in use.**

121. **An entity shall disclose the following information for the aggregate impairment losses and the aggregate reversals of impairment losses recognized during the period for which no information is disclosed in accordance with paragraph 120:**

(a) **The main classes of assets affected by impairment losses and the main classes of assets affected by reversals of impairment losses; and**

(b) **The main events and circumstances that led to the recognition of these impairment losses and reversals of impairment losses.**

122. An entity is encouraged to disclose assumptions used to determine the recoverable amount of assets during the period. However, paragraph 123 requires an entity to disclose information about the estimates used to measure the recoverable amount of a cash-generating unit when an intangible asset with an indefinite useful life is included in the carrying amount of that unit.

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

123. **An entity shall disclose the information required by (a)–(e) for each cash-generating unit for which the carrying amount of intangible assets with indefinite useful lives allocated to that unit is significant in comparison with the entity's total carrying amount of intangible assets with indefinite useful lives:**

(a) **The carrying amount of intangible assets with indefinite useful lives allocated to the unit;**

(b) **The basis on which the unit's recoverable amount has been determined (i.e., value in use or fair value less costs to sell);**

(c) **If the unit's recoverable amount is based on value in use:**

(i) **A description of each key assumption on which management has based its cash flow projections for the period covered by the most recent budgets/forecasts. Key assumptions are those to which the unit's recoverable amount is most sensitive;**

(ii) **A description of management's approach to determining the value(s) assigned to each key assumption, whether those value(s) reflect past experience or, if appropriate, are**

consistent with external sources of information, and, if not, how and why they differ from past experience or external sources of information;

(iii) **The period over which management has projected cash flows based on financial budgets/forecasts approved by management and, when a period greater than five years is used for a cash-generating unit, an explanation of why that longer period is justified;**

(iv) **The growth rate used to extrapolate cash flow projections beyond the period covered by the most recent budgets/forecasts, and the justification for using any growth rate that exceeds the long-term average growth rate for the products, industries, or country or countries in which the entity operates, or for the market to which the unit is dedicated; and**

(v) **The discount rate(s) applied to the cash flow projections.**

(d) **If the unit's recoverable amount is based on fair value less costs to sell, the methodology used to determine fair value less costs to sell. If fair value less costs to sell is not determined using an observable market price for the unit, the following information shall also be disclosed:**

(i) **A description of each key assumption on which management has based its determination of fair value less costs to sell. Key assumptions are those to which the unit's recoverable amount is most sensitive; and**

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

(e) **If a reasonably possible change in a key assumption on which management has based its determination of the unit's recoverable amount would cause the unit's carrying amount to exceed its recoverable amount:**

(i) **The amount by which the unit's recoverable amount would exceed its carrying amount;**

(ii) **The value assigned to the key assumption; and**

(iii) **The amount by which the value assigned to the key assumption must change, after incorporating any**

consequential effects of that change on the other variables used to measure recoverable amount, in order for the unit's recoverable amount to be equal to its carrying amount.

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

(a) **The aggregate carrying amount of intangible assets with indefinite useful lives allocated to those units;**

(b) **A description of the key assumption(s);**

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

(d) **If a reasonably possible change in the key assumption(s) would cause the aggregate of the units' carrying amounts to exceed the aggregate of their recoverable amounts:**

(i) **The amount by which the aggregate of the units' recoverable amounts would exceed the aggregate of their carrying amounts;**

(ii) **The value(s) assigned to the key assumption(s); and**

(iii) **The amount by which the value(s) assigned to the key assumption(s) must change, after incorporating any consequential effects of the change on the other variables used to measure recoverable amount, in order for the aggregate of the units' recoverable amounts to be equal to the aggregate of their carrying amounts.**

125. The most recent detailed calculation made in a preceding period of the recoverable amount of a cash-generating unit may, in accordance with paragraph 37, be carried forward and used in the impairment test for that unit in the current period provided specified criteria are met. When this is the case,

the information for that unit that is incorporated into the disclosures required by paragraphs 123 and 124 relate to the carried forward calculation of recoverable amount.

Effective Date

126. **An entity shall apply this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after April 1 2009. Earlier application is encouraged. If an entity applies this Standard for an earlier period, it shall disclose that fact.**

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

Appendix A

Using Present Value Techniques to Measure Value in Use

This appendix is an integral part of IPSAS 26. It provides guidance on the use of present value techniques in measuring value in use. Although the guidance uses the term asset, it equally applies to a group of assets forming a cash-generating unit.

The Components of a Present Value Measurement

A1. The following elements together capture the economic differences between cash-generating assets:

(a) An estimate of the future cash flow, or, in more complex cases, series of future cash flows the entity expects to derive from the asset;

(b) Expectations about possible variations in the amount or timing of those cash flows;

(c) The time value of money, represented by the current market risk-free rate of interest;

(d) The price for bearing the uncertainty inherent in the asset; and

(e) Other, sometimes unidentifiable, factors (such as illiquidity) that market participants would reflect in pricing the future cash flows the entity expects to derive from the asset.

A2. This appendix contrasts two approaches to computing present value, either of which may be used to estimate the value in use of an asset, depending on the circumstances. Under the traditional approach, adjustments for factors (b)–(e) described in paragraph A1 are embedded in the discount rate. Under the expected cash flow approach, factors (b), (d) and (e) cause adjustments in arriving at risk-adjusted expected cash flows. Whichever approach an entity adopts to reflect expectations about possible variations in the amount or timing of future cash flows, the result should be to reflect the expected present value of the future cash flows, i.e., the weighted average of all possible outcomes.

General Principles

A3. The techniques used to estimate future cash flows and interest rates will vary from one situation to another depending on the circumstances surrounding the asset in question. However, the following general principles govern any application of present value techniques in measuring assets:

(a) Interest rates used to discount cash flows should reflect assumptions that are consistent with those inherent in the estimated cash flows. Otherwise, the effect of some assumptions will be double-counted or ignored. For example, a discount rate of 12 percent might be applied to contractual cash flows of a loan receivable. That rate reflects expectations about future defaults from loans with particular characteristics. That same 12 percent rate should not be used to discount expected cash flows because those cash flows already reflect assumptions about future defaults.

(b) Estimated cash flows and discount rates should be free from both bias and factors unrelated to the asset in question. For example, deliberately understating estimated net cash flows to enhance the apparent future profitability of an asset introduces a bias into the measurement.

(c) Estimated cash flows or discount rates should reflect the range of possible outcomes rather than a single most likely minimum or maximum possible amount.

Traditional and Expected Cash Flow Approaches to Present Value

Traditional Approach

A4. Accounting applications of present value have traditionally used a single set of estimated cash flows and a single discount rate, often described as the rate commensurate with the risk. In effect, the traditional approach assumes that a single discount rate convention can incorporate all the expectations about the future cash flows and the appropriate risk premium. Therefore, the traditional approach places most of the emphasis on selection of the discount rate.

A5. In some circumstances, such as those in which comparable assets can be observed in the marketplace, a traditional approach is relatively easy to apply. For assets with contractual cash flows, it is consistent with the manner in which marketplace participants describe assets, as in a 12 percent bond.

A6. However, the traditional approach may not appropriately address some complex measurement problems, such as the measurement of non-financial assets for which no market for the item or a comparable item exists. A proper search for the rate commensurate with the risk requires analysis of at least two items—an asset that exists in the marketplace and has an observed interest rate and the asset being measured. The appropriate discount rate for the cash flows being measured must be inferred from the observable rate of interest in that other asset. To draw that inference, the characteristics of the other asset's cash flows must be similar to those of the asset being measured. Therefore, the measurer must do the following:

(a) Identify the set of cash flows that will be discounted;

(b) Identify another asset in the marketplace that appears to have similar cash flow characteristics;

(c) Compare the cash flow sets from the two items to ensure that they are similar (for example, are both sets contractual cash flows, or is one contractual and the other an estimated cash flow?);

(d) Evaluate whether there is an element in one item that is not present in the other (for example, is one less liquid than the other?); and

(e) Evaluate whether both sets of cash flows are likely to behave (i.e., vary) in a similar fashion in changing economic conditions.

Expected Cash Flow Approach

A7. The expected cash flow approach is, in some situations, a more effective measurement tool than the traditional approach. In developing a measurement, the expected cash flow approach uses all expectations about possible cash flows instead of the single most likely cash flow. For example, a cash flow might be CU100[1], CU200 or CU300 with probabilities of 10 percent, 60 percent and 30 percent, respectively. The expected cash flow is CU220. The expected cash flow approach thus differs from the traditional approach by focusing on direct analysis of the cash flows in question and on more explicit statements of the assumptions used in the measurement.

A8. The expected cash flow approach also allows use of present value techniques when the timing of cash flows is uncertain. For example, a cash flow of CU1,000 may be received in one year, two years or three years with probabilities of 10 percent, 60 percent and 30 percent, respectively. The example below shows the computation of expected present value in that situation.

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

A9. The expected present value of CU892.36 differs from the traditional notion of a best estimate of CU902.73 (the 60 percent probability). A traditional present value computation applied to this example requires a decision about which of the possible timings of cash flows to use and, accordingly, would not reflect

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

the probabilities of other timings. This is because the discount rate in a traditional present value computation cannot reflect uncertainties in timing.

A10. The use of probabilities is an essential element of the expected cash flow approach. Some question whether assigning probabilities to highly subjective estimates suggests greater precision than, in fact, exists. However, the proper application of the traditional approach (as described in paragraph A6) requires the same estimates and subjectivity without providing the computational transparency of the expected cash flow approach.

A11. Many estimates developed in current practice already incorporate the elements of expected cash flows informally. In addition, accountants often face the need to measure an asset using limited information about the probabilities of possible cash flows. For example, an accountant might be confronted with the following situations:

(a) The estimated amount falls somewhere between CU50 and CU250, but no amount in the range is more likely than any other amount. Based on that limited information, the estimated expected cash flow is CU150 [(50+250)/2];

(b) The estimated amount falls somewhere between CU50 and CU250, and the most likely amount is CU100. However, the probabilities attached to each amount are unknown. Based on that limited information, the estimated expected cash flow is CU133.33 [(50+100+250)/3]; or

(c) The estimated amount will be CU50 (10 percent probability), CU250 (30 percent probability), or CU100 (60 percent probability). Based on that limited information, the estimated expected cash flow is CU140 [(50 × 0.10)+(250 × 0.30)+(100 × 0.60)]. In each case, the estimated expected cash flow is likely to provide a better estimate of value in use than the minimum, most likely or maximum amount taken alone.

A12. The application of an expected cash flow approach is subject to a cost-benefit constraint. In some cases, an entity may have access to extensive data and may be able to develop many cash flow scenarios. In other cases, an entity may not be able to develop more than general statements about the variability of cash flows without incurring substantial cost. The entity needs to balance the cost of obtaining additional information against the additional reliability that information will bring to the measurement.

A13. Some maintain that expected cash flow techniques are inappropriate for measuring a single item or an item with a limited number of possible outcomes. They offer an example of an asset with two possible outcomes: a 90 percent probability that the cash flow will be CU10 and a 10 percent probability that the cash flow will be CU1,000. They observe that the expected cash flow in that example is CU109 and criticize that result as not representing either of the amounts that may ultimately be paid.

A14. Assertions like the one just outlined reflect underlying disagreement with the measurement objective. If the objective is accumulation of costs to be incurred, expected cash flows may not produce a representationally faithful estimate of the expected cost. However, this Standard is concerned with measuring the recoverable amount of an asset. The recoverable amount of the asset in this example is not likely to be CU10, even though that is the most likely cash flow. This is because a measurement of CU10 does not incorporate the uncertainty of the cash flow in the measurement of the asset. Instead, the uncertain cash flow is presented as if it were a certain cash flow. No rational entity would sell an asset with these characteristics for CU10.

Discount Rate

A15. Whichever approach an entity adopts for measuring the value in use of an asset, interest rates used to discount cash flows should not reflect risks for which the estimated cash flows have been adjusted. Otherwise, the effect of some assumptions will be double-counted.

A16. When an asset-specific rate is not directly available from the market, an entity uses surrogates to estimate the discount rate. The purpose is to estimate, as far as possible, a market assessment of:

(a) The time value of money for the periods until the end of the asset's useful life; and

(b) Factors (b), (d) and (e) described in paragraph A1, to the extent those factors have not caused adjustments in arriving at estimated cash flows.

A17. As a starting point in making such an estimate, the entity might take into account the following rates:

(a) The entity's weighted average cost of capital determined using techniques such as the Capital Asset Pricing Model;

(b) The entity's incremental borrowing rate; and

(c) Other market borrowing rates.

A18. However, these rates must be adjusted:

(a) To reflect the way that the market would assess the specific risks associated with the asset's estimated cash flows; and

(b) To exclude risks that are not relevant to the asset's estimated cash flows or for which the estimated cash flows have been adjusted. Consideration should be given to risks such as country risk, currency risk and price risk.

A19. The discount rate is independent of the entity's capital structure and the way the entity financed the purchase of the asset, because the future cash flows expected to arise from an asset do not depend on the way in which the entity financed the purchase of the asset.

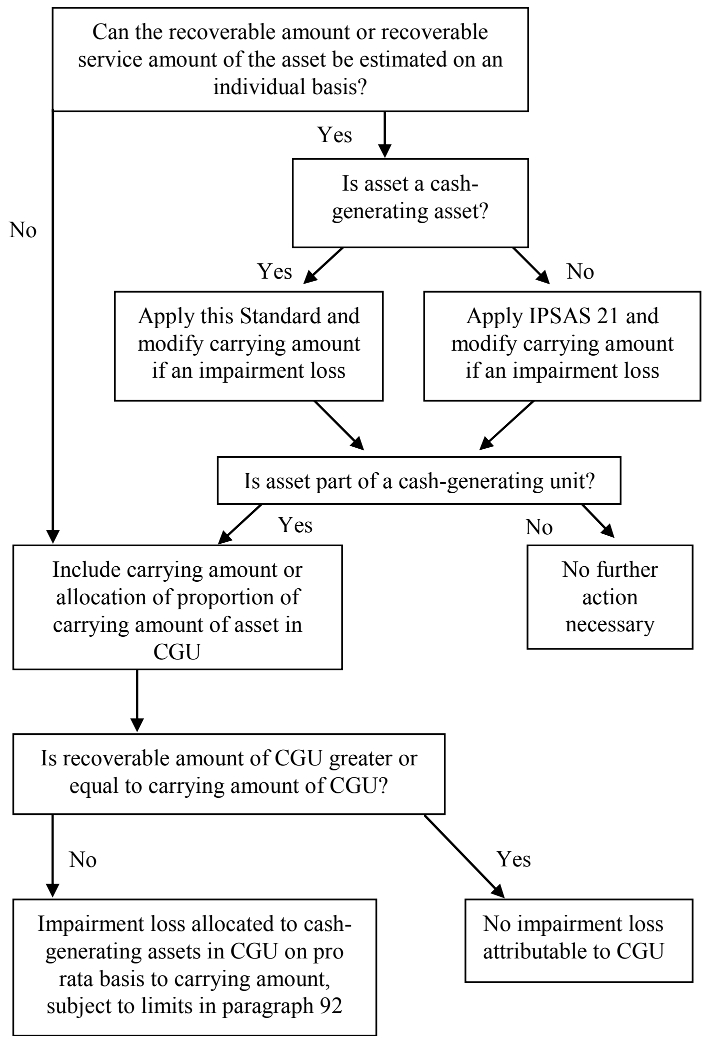
A20. Paragraph 68 requires the discount rate used to be a pre-tax rate. Therefore, when the basis used to estimate the discount rate is post-tax, that basis is adjusted to reflect a pre-tax rate.

A21. An entity normally uses a single discount rate for the estimate of an asset's value in use. However, an entity uses separate discount rates for different future periods where value in use is sensitive to a difference in risks for different periods or to the term structure of interest rates.

Appendix B

Individual Assets in Cash-Generating Units (CGUs)

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



Appendix C

Amendments to Other IPSASs

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

Paragraphs 4 and 5 are amended:

4. **Public sector entities that hold cash-generating assets as defined in paragraph 14 shall apply ~~International Accounting Standard IAS 36, "Impairment of Assets"~~ IPSAS 26, "Impairment of Cash-Generating Assets" to such assets. Public sector entities that hold non-cash-generating assets shall apply the requirements of this Standard to non-cash-generating assets.**

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

Paragraph 14 is amended:

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

Paragraph 16 is deleted:

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

The following paragraphs are added:

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

16B. There are a number of circumstances in which public sector entities may hold some assets with the primary objective of generating a commercial return, although the majority of assets are not held for that purpose. For example, a hospital may deploy a building for fee-paying patients. Cash-generating assets of a public sector entity may operate independently of the non-cash-generating assets of the entity. For example, the deeds office may earn land registration fees independently from the department of land affairs.

16C. In certain instances, an asset may generate cash flows although it is primarily held for service delivery purposes. For example, a waste disposal plant is operated to ensure the safe disposal of medical waste generated by state controlled hospitals, but the plant also treats a small amount of medical waste generated by other private hospitals on a commercial basis. The treatment of medical waste from the private hospitals is incidental to the activities of the plant, and the assets that generate cash flows cannot be distinguished from the non-cash-generating assets.

16D. In other instances, an asset may generate cash flows and also be used for non-cash-generating purposes. For example, a public hospital has ten wards, nine of which are used for fee-paying patients on a commercial basis, and the other is used for non-fee paying patients. Patients from both wards jointly use other hospital facilities (for example, operating facilities). The extent to which the asset is held with the objective of providing a commercial return needs to be considered to determine whether the entity should apply the provisions of this Standard or IPSAS 26, “Impairment of Cash-Generating Assets.” If, as in this example, the non-cash-generating component is an insignificant component of the arrangement as a whole, the entity applies IPSAS 26 rather than this Standard.

16E. In some cases it may not be clear whether the primary objective of holding an asset is to generate a commercial return. In such cases it is necessary to evaluate the significance of the cash flows. It may be difficult to determine whether the extent to which the asset generates cash flows is so significant that this Standard is applicable rather than IPSAS 26. Judgment is needed to determine which Standard to apply. An entity develops criteria so that it can exercise that judgment consistently in accordance with the definition of cash-generating assets and non-cash-generating assets and with the related guidance in paragraphs 16A–16E. Paragraph 67B requires an entity to disclose the criteria used in making this judgment. However, given the overall objectives of most public sector entities, other than GBEs, the presumption is that assets are non-cash-generating and, therefore, IPSAS 21 will apply.

Paragraph 67 is redesignated as black letter:

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

The following paragraphs are added:

67A. There are circumstances in which public sector entities may decide that it is appropriate to redesignate a non-cash-generating asset as a cash-generating asset. For example, an effluent treatment plant was constructed primarily to treat industrial effluent from a social housing unit, for which no charge is made. The social housing unit has been demolished and the site will be developed for industrial and retail purposes. It is intended that, in future, the plant will be used to treat industrial effluent at commercial rates. In light of this decision the public sector entity decides to redesignate the effluent treatment plant as a cash-generating asset.

67B. **An entity shall disclose the criteria developed by the entity to distinguish non-cash-generating assets from cash-generating assets.**

In the Basis for Conclusions the following paragraphs are amended:

C4 IAS 36 requires an entity to determine value in use as the present value of estimated future cash flows expected to be derived from the continuing use of the asset, or cash-generating unit, and from its disposal at the end of its useful life. The service potential of cash-generating assets is reflected by their ability to generate future cash flows. IPSAS 26, "Impairment of Cash-Generating Assets" is based on IAS 36. The requirements of ~~IAS 36~~ IPSAS 26 are applicable to cash-generating assets held by public sector entities. This Standard requires entities to apply ~~IAS 36~~ IPSAS 26 to account for the impairment of cash-generating assets in the public sector.

In the Basis for Conclusions the following paragraph is deleted:

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

Implementation Guidance

Contents

This guidance accompanies, but is not part of, IPSAS 26. All the examples assume that the entities concerned have no transactions other than those described.

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

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

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

Example 1—Identification of Cash-Generating Units

The purpose of this example is:

(a) *To indicate how cash-generating units are identified in various situations; and*

(b) *To highlight certain factors that an entity may consider in identifying the cash-generating unit to which an asset belongs.*

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

Background

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

Analysis

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

B—Government Air Freight Unit that Leases an Aircraft

Background

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

Analysis

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

C—Crushing Plant in Waste Disposal Entity

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

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

D—Routes Provided by Bus Company

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

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

Example 2—Calculation of Value in Use and Recognition of an Impairment Loss

Background and Calculation of Value in Use

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

IG10. At the beginning of 20X4, power plants constructed by competitors are put into service resulting in a reduction in the revenues produced by the power plant of Government R. Reductions in revenue result because the volume of electricity generated has decreased from expectations and also because the prices for electricity and stand-by capacity have decreased from expectations.

IG11. The reduction in revenue is evidence that the economic performance of the asset is worse than expected. Consequently, Government R is required to determine the asset's recoverable amount.

IG12. Government R uses straight-line depreciation over a 20-year life for the power plant and anticipates no residual value.

IG13. It is not possible to determine the fair value less costs to sell of the power plant. Therefore, recoverability can only be determined through the calculation of value in use. To determine the value in use for the power plant (see Schedule 1), Government R:

(a) Prepares cash flow forecasts derived from the most recent financial budgets/forecasts for the next five years (years 20X5–20X9) approved by management;

(b) Estimates subsequent cash flows (years 20Y0–20Y9) based on declining growth rates ranging from -6 percent per annum to -3 percent per annum; and

(c) Selects a 6 percent discount rate, which represents a rate that reflects current market assessments of the time value of money and the risks specific to Government R's power plant.

Recognition and Measurement of Impairment Loss

IG14. The recoverable amount of Government R's power plant is CU121.1 million.

IG15. Government R compares the recoverable amount of the power plant to its carrying amount (see Schedule 2).

IG16. Because the carrying amount exceeds the recoverable amount by CU78.9 million, an impairment loss of CU78.9 million is recognized immediately in surplus or deficit.

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

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

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

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

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

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

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

Example 3—Reversal of an Impairment Loss

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

Background

IG17. By 20X6 some competitors have closed down power plants and this has meant that the negative impact on the revenues of Government R has been less than projected at the end of 2004. This favorable change requires the government to reestimate the recoverable amount of the power plant.

IG18. Calculations similar to those in Example 2 show that the recoverable amount of the power plant is now CU157.7 million.

Reversal of Impairment Loss

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

Example 4—Non-Cash-Generating Asset which Contributes to a Cash-Generating Unit

Background

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

Determination of Recoverable Amount of Cash-Generating Unit

IG21. During the year there had been a significant reduction in the number of fee-paying patients at the hospital. The CGU is therefore tested for impairment. The recoverable amount of the CGU, based on its value in use, is assessed as

CU27,400. 20% of the revised carrying value of the MRI scanner (CU400) is allocated to the carrying amount of the CGU before determining the impairment loss (CU3,000). The impairment loss is allocated to the building and capital equipment pro rata based on their carrying values. No further impairment loss is allocated to the MRI scanner as an impairment loss has already been determined under the requirements of IPSAS 21, "Impairment of Non-Cash-Generating Assets."

Example 5—Inclusion of Recognized Liabilities in Calculation of Recoverable Amount of a Cash-Generating Unit

Background

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

Impairment Testing

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

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

Example 6—Accounting Treatment of an Individual Asset in a Cash-Generating Unit dependent on whether Recoverable Amount can be Determined

Background

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

Recoverable Amount of Holding Tank Cannot be Determined

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

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

(a) May differ from its fair value less costs to sell; and

(b) Can be determined only for the cash-generating unit to which the holding tank belongs (the water purification plant).

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

Recoverable Amount of Holding Tank Can be Determined

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

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

Basis for Conclusions

This Basis for Conclusions accompanies, but is not part of, the International Public Sector Accounting Standard.

Introduction

BC1. The International Public Sector Accounting Standards Board (the IPSASB) issued IPSAS 21, "Impairment of Non-Cash-Generating Assets" in December 2004. IPSAS 21 prescribes the procedures that an entity applies to determine whether a non-cash-generating asset is impaired and establishes how the impairment is recognized and measured. The majority of assets in the public sector are non-cash-generating and the recognition and measurement requirements developed resulted in a number of differences in IPSAS 21 from International Accounting Standard, IAS 36, "Impairment of Assets."

Need for this IPSAS

BC2. IPSAS 21 referred readers to IAS 36 in order to establish whether cash-generating assets have been impaired and for accounting for the recognition and measurement of any impairment. There are benefits in incorporating requirements and guidance on the impairment of cash-generating assets in an IPSAS, so that public sector entities do not have to refer to IAS 36 when an entity has cash-generating assets. In addition there are a number of public sector issues related to impairment. These include:

(a) Whether cash-generating property, plant and equipment carried in accordance with the revaluation model in IPSAS 17, "Property, Plant and Equipment" should be within the scope;

(b) Distinguishing cash-generating and non-cash-generating assets;

(c) The redesignation of cash-generating assets to non-cash-generating assets and vice-versa; and

(d) The treatment for impairment purposes of non-cash-generating assets in cash-generating units.

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

BC3. The scope of IPSAS 21 excludes non cash-generating property, plant and equipment carried at revalued amounts in accordance with the revaluation model in IPSAS 17. The Basis for Conclusions in IPSAS 21 states that the IPSASB is of the view that assets carried at revalued amounts in accordance with the revaluation model in IPSAS 17 will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date and that any impairment will be taken into account in that valuation. The IPSASB therefore considered whether a similar scope exclusion should be included in this IPSAS.

BC4. The IPSASB acknowledged that property, plant and equipment held on the revaluation model are within the scope of IAS 36, and considered the view that guidance on determining impairment losses for such assets would be appropriate for public sector entities with assets on the revaluation model. The IPSASB noted that in IAS 36, in cases where the fair value of an item of property, plant and equipment is its market value, the maximum amount of an impairment loss is the disposal costs. In the Basis for Conclusions for IPSAS 21, it is stated that "the IPSASB is of the view that, in most cases, these will not be material and, from a practical viewpoint, it is not necessary to measure an asset's recoverable service amount and to recognize an impairment loss for the disposal costs of a non-cash-generating asset." The IPSASB considered that disposal costs are also unlikely to be material for cash-generating assets.

BC5. For specialized cash-generating assets where fair value has not been derived from market value, IAS 36 requires recoverability to be estimated through the value in use. Because value in use is based on cash flow projection, it might be materially greater or lower than carrying amount. This analysis is also relevant in the public sector. However, it is questionable whether public sector entities hold specialized assets which meet the definition of a cash-generating asset in this Standard.

BC6. The IPSASB remains of the view that it would be onerous to impose a requirement to test for impairment in addition to the existing requirement in IPSAS 17 that assets will be revalued with sufficient regularity to ensure that they are carried at an amount that is not materially different from their fair value at the reporting date. Therefore, on balance, the IPSASB concluded that consistency with IPSAS 21 should take precedence over convergence with IAS 36 and that property, plant and equipment carried on the revaluation model in IPSAS 17 should be excluded from the scope of this Standard. Consistent with the approach to property, plant and equipment, intangible assets that are regularly revalued to fair value are also excluded from the scope.

Exclusion of Goodwill from Scope

BC7. IAS 36 contains extensive requirements and guidance on the impairment of goodwill, the allocation of goodwill to cash-generating units and testing cash-generating units with goodwill for impairment. The IPSASB considered whether goodwill should be within the scope of this Standard. The IPSASB has not yet issued an IPSAS dealing with entity combinations and considers it likely that a number of public sector specific issues will arise when combinations of public sector entities take place: in particular whether an acquirer can always be identified in combinations of public sector entities. The IPSASB concluded that goodwill should not be within the scope of this Standard. In accordance with the hierarchy in IPSAS 3, "Accounting Policies, Changes in Accounting Estimates and Errors," users are referred to the requirements of the relevant international or national accounting standards dealing with the impairment of goodwill, with the allocation of goodwill to cash-generating units and the testing for impairment of cash-generating units with goodwill.

Distinguishing Cash-Generating and Non-Cash-Generating Assets

BC8. The IPSASB noted that some assets have both cash-generating and non-cash-generating characteristics. The IPSASB considered whether it should adopt a components-based approach that would identify the cash-generating and non-cash-generating components of assets and subject them to different treatments. The IPSASB rejected such an approach because of cost-benefit considerations. The IPSASB concluded that assets in the public sector are generally non-cash-generating, and that an analysis of their service potential is the preferred basis to determine impairment. This Standard therefore includes a rebuttable presumption at paragraph 18 that assets that are both cash-generating and non-cash-generating should be treated as non-cash-generating assets.

Indications of Impairment: Market Capitalization

BC9. The IPSASB considered whether the indications for impairment of cash-generating assets held by public sector entities—both external sources and internal sources of information—are similar to those in IAS 36. The IPSASB concluded that the indications in IAS 36 are relevant, except for the indication that the carrying amount of the net assets of the entity is more than its market capitalization. The IPSASB is of the view that very few public sector entities that are not GBEs will issue equity instruments traded in deep markets and that, therefore, such an indication will only be relevant on the consolidation of GBEs.

Fair Value less Costs to Sell and Forced Sales

BC10. In commentary on the definition of "fair value less costs to sell," IAS 36 states that "fair value less costs to sell does not reflect a forced sale," but includes a qualification: "unless management is compelled to sell immediately." IPSAS 26 does not include this qualification in paragraph 40 because there are very few circumstances in which public sector entities, which are not GBEs, will be forced to sell immediately in order to remain a going concern.

Redesignation of Assets

BC11. Cash-generating assets can become non-cash-generating assets and vice-versa. The IPSASB considered under what circumstances a redesignation of an asset from cash-generating to non-cash-generating and vice-versa should be permitted. The IPSASB concluded that a redesignation can occur only when there is clear evidence that it is appropriate. The IPSASB also concluded that a redesignation by itself does not trigger an impairment test or the reversal of an impairment loss. Instead, at the subsequent reporting date, an entity should evaluate the appropriate indicators following redesignation to determine if a test is needed. These requirements are stated in paragraph 112.

Cash-Generating Units

BC12. As in IAS 36, where it is not possible to determine the recoverable amount for an individual asset, then the recoverable amount for the asset's cash-generating unit (CGU) will be determined. The CGU is the smallest identifiable group of assets that generates cash inflows from continuing use and that is largely independent of the cash inflows from other assets or groups of assets. The IPSASB concluded that the notion of a CGU is appropriate for cash-generating assets in a public sector context.

Corporate Assets

BC13. IAS 36 includes requirements related to corporate assets. Corporate assets are defined in IAS 36 as "assets other than goodwill that contribute to the future cash flows of both the cash-generating unit under review and other cash-generating units"—that is, a corporate asset contributes only to CGUs and not to non-cash-generating activities. The IPSASB considered whether this Standard should include requirements for corporate assets as defined in IAS 36.

BC14. The primary purpose of public sector entities that are not GBEs is not the generation of commercial returns. Therefore, the IPSASB considers that there will be very few occasions in which an asset shared between different activities (such as an administrative building) contributes service potential to CGUs without also contributing service potential to non-cash-generating activities. It was therefore decided that it is not necessary to define, and provide requirements for, corporate assets in this Standard. Paragraph 96 refers entities to the relevant international and national accounting standard dealing with assets that do not generate cash flows independently of other assets and form part of more than one cash-generating unit, but do not contribute service potential to non-cash-generating activities.

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

BC15. There are likely to be a number of cases in which public sector entities hold non-cash-generating assets that contribute service potential to CGUs in addition to non-cash-generating activities. The IPSASB considered the approach to the treatment of such non-cash-generating assets in CGUs. In particular, the IPSASB considered whether it is appropriate to include a proportion of the carrying amount of a non-cash-generating asset, following any impairment test under IPSAS 21, in the carrying amount of the CGU when comparing the carrying amount of that CGU with its recoverable amount.

BC16. The IPSASB concluded that a proportion of the carrying amount of such a non-cash-generating asset should be included in the carrying amount of the CGU. That proportion should be determined on a basis pro rata to the service potential that such an asset contributes to the CGU. If the non-cash-generating asset is ignored, the carrying amount of the CGU may be understated and impairment losses not recognized. However, because any impairment of the non-cash-generating asset will have been determined in accordance with IPSAS 21, the non-cash-generating asset will have been written down to its recoverable service amount. Therefore, no further impairment loss relating to the CGU should be applied to the non-cash-generating asset. Any impairment losses are allocated on a pro rata basis, based on carrying values, to the cash-generating assets in the CGU, subject to the limits in paragraph 92. This approach is reflected in paragraph 95.

Comparison with IAS 36

IPSAS 26, “Impairment of Cash-Generating Assets” deals with the impairment of cash-generating assets in the public sector. The main differences between IPSAS 26 and IAS 36 (2004), “Impairment of Assets” are as follows:

- IPSAS 26 does not apply to cash-generating assets carried at revalued amounts at the reporting date under the revaluation model in International Public Sector Accounting Standard 17, “Property, Plant and Equipment.” IAS 36 does not exclude from its scope cash-generating property, plant and equipment carried at revalued amounts at the reporting date.
- IPSAS 26 does not apply to intangible assets that are regularly revalued to fair value. IAS 36 does not exclude from its scope intangible assets that are regularly revalued to fair value.
- Goodwill is outside the scope of IPSAS 26. IAS 36 includes extensive requirements and guidance on the impairment of goodwill, the allocation of goodwill to cash-generating units and testing cash-generating units with goodwill for impairment.
- IPSAS 26 defines cash-generating assets and includes additional commentary to distinguish cash-generating assets and non-cash-generating assets.
- The definition of a cash-generating unit in IPSAS 26 is modified from that in IAS 36.
- IPSAS 26 does not include a definition of corporate assets or requirements relating to such assets. IAS 36 includes a definition of corporate assets and requirements and guidance on their treatment.
- IPSAS 26 does not include the carrying amount of the net assets of an entity being more than the entity’s market capitalization as a black letter indication of impairment. The carrying amount of the net assets of an entity being more than the entity’s market capitalization appears in black letter in IAS 36 as part of the minimum set of indications of impairment.
- In IPSAS 26 a forced sale is not a reflection of fair value less costs to sell. In IAS 36 a forced sale is a reflection of fair value less costs to sell, if management is compelled to sell immediately.
- IPSAS 26 includes requirements and guidance on the treatment of non-cash-generating assets that contribute to cash-generating units as well as to non-cash-generating activities. IAS 36 does not deal with non-cash-generating assets that contribute to cash-generating units as well as to non-cash-generating activities.
- IPSAS 26 includes requirements and guidance dealing with the redesignation of assets from cash-generating to non-cash-generating and non-cash-generating to cash-generating. IPSAS 26 also requires entities to disclose the criteria developed

to distinguish cash-generating assets from non-cash-generating assets. There are no equivalent requirements in IAS 36.

- IPSAS 26 uses different terminology, in certain instances, from IAS 36. The most significant examples are the use of the terms revenue, statement of financial performance and statement of financial position. The equivalent terms in IAS 36 are income, income statement and balance sheet.

Introduction

Accounting Standards for the Public Sector

The International Public Sector Accounting Standards Board (the IPSASB) of the International Federation of Accountants (IFAC) develops accounting standards for public sector entities referred to as International Public Sector Accounting Standards (IPSASs). The IPSASB recognizes the significant benefits of achieving consistent and comparable financial information across jurisdictions and it believes that the IPSASs will play a key role in enabling these benefits to be realized. The adoption of IPSASs by governments will improve both the quality and comparability of financial information reported by public sector entities around the world.

IPSASs are being prepared for application by entities adopting the accrual basis of accounting and for application by entities adopting the cash basis of accounting.

The IPSASB recognizes the right of governments and national standard setters to establish guidelines and accounting standards for financial reporting. The IPSASB considers that this Standard is an important step forward in improving the consistency and comparability of financial reporting under the cash basis of accounting and encourages the adoption of this Standard. Financial statements should be described as complying with this IPSAS only if they comply with all the requirements of Part 1 of this IPSAS.

The IPSASB encourages governments to progress to the accrual basis of accounting and to harmonize national requirements with the IPSASs prepared for application by entities adopting the accrual basis of accounting. Entities intending to adopt the accrual basis of accounting at some time in the future may find other publications of the IPSASB helpful, particularly Study 14, *Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities*.

INTERNATIONAL PUBLIC SECTOR ACCOUNTING STANDARD: FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

Structure of the Standard

This Standard comprises two parts:

- Part 1 is mandatory. It sets out the requirements which are applicable to all entities preparing general purpose financial statements under the cash basis of accounting. It defines the cash basis of accounting, establishes requirements for the disclosure of information in the financial statements and supporting notes, and deals with a number of specific reporting issues. The requirements in this part of the Standard must be complied with by entities which claim to be reporting in accordance with the International Public Sector Accounting Standard *Financial Reporting Under The Cash Basis of Accounting*.

  Sections 1.1 to 1.8 of Part 1 of this Standard were issued in 2003. Section 1.9 of Part 1, "Presentation of Budget Information in Financial Statements" was issued in 2006. Amendments were made to paragraphs 1.3.4(c), 1.3.7, 1.3.9(c) and Appendix 1 of Part 1 in 2006 as a consequence of the issue of Section 1.9. Section 1.10 of Part 1, "Recipients of External Assistance" was issued in 2007. Amendments were made to paragraphs 1.3.18 and Appendix 1 of Part 1 in 2007 as a consequence of the issue of Section 1.10.

- Part 2 is not mandatory. It identifies additional accounting policies and disclosures that an entity is encouraged to adopt to enhance its financial accountability and the transparency of its financial statements. It includes explanations of alternative methods of presenting certain information.

  Paragraphs 2.1.1 to 2.1.59 of Section 2.1, Section 2.2 and Appendices 2, 3, 4 and 5 were issued in 2003. Paragraphs 2.1.37 to 2.1.40 were added to Part 2 in 2006 to encourage certain disclosures about budget and actual amounts, and paragraph 2.1.36 and Appendix 2 were revised as a consequence. Paragraphs 2.1.64 to 2.1.93 were added to Part 2 in 2007 to encourage certain disclosures about external assistance, and paragraphs 2.1.25, 2.1.30 and Appendix 2 were revised as a consequence.

FINANCIAL REPORTING UNDER THE CASH BUSINESS OF ACCOUNTING

CONTENTS

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING

PART 1: REQUIREMENTS

Part 1 of this Standard sets out the requirements for reporting under the cash basis of accounting.

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

Objective

The purpose of this Standard is to prescribe the manner in which general purpose financial statements should be presented under the cash basis of accounting.

Information about the cash receipts, cash payments and cash balances of an entity is necessary for accountability purposes and provides input useful for assessments of the ability of the entity to generate adequate cash in the future and the likely sources and uses of cash. In making and evaluating decisions about the allocation of cash resources and the sustainability of the entity's activities, users require an understanding of the timing and certainty of cash receipts and cash payments.

Compliance with the requirements and encouragements of this Standard will enhance comprehensive and transparent financial reporting of the cash receipts, cash payments and cash balances of the entity. It will also enhance comparability with the entity's own financial statements of previous periods and with the financial statements of other entities which adopt the cash basis of accounting.

1.1 Scope of the Requirements

1.1.1 ***An entity which prepares and presents financial statements under the cash basis of accounting, as defined in this Standard, should apply the requirements of Part 1 of this Standard in the presentation of its general purpose annual financial statements.***

1.1.2 General purpose financial statements are those intended to meet the needs of users who are not in a position to demand reports tailored to meet their specific information needs. Users of general purpose financial statements include taxpayers and ratepayers, members of the legislature, creditors, suppliers, the media and employees. General purpose financial statements include those financial statements that are presented separately or within another public document such as an annual report.

1.1.3 This Standard applies equally to the general purpose financial statements of an individual entity and to the consolidated general purpose financial statements of an economic entity such as a whole-of-government. It requires the preparation of a statement of cash receipts and payments which recognizes the cash controlled by the reporting entity, and the disclosure of accounting policies and explanatory notes. It also requires that amounts settled on behalf of the reporting entity by third parties be disclosed on the face of the statement of cash receipts and payments.

1.1.4 ***An entity whose financial statements comply with the requirements of Part 1 of this Standard should disclose that fact. Financial statements should not be described as complying with this Standard unless they comply with all the requirements in Part 1 of the Standard.***

1.1.5 ***This Standard applies to all public sector entities other than Government Business Enterprises.***

1.1.6 The *Preface to International Financial Reporting Standards* issued by the International Accounting Standards Board (IASB) explains that International Financial Reporting Standards (IFRSs) are designed to apply to the general purpose financial statements of all profit-oriented entities. Government Business Enterprises (GBEs) are defined in paragraph 1.2.1 below. They are profit-oriented entities. Accordingly, they are required to comply with IFRSs and International Accounting Standards (IASs).

1.1.7 The International Accounting Standards Board (IASB) was established in 2001 to replace the International Accounting Standards Committee (IASC). The IASs issued by the IASC remain in force until they are amended or withdrawn by the IASB.

1.2 The Cash Basis

Definitions

1.2.1 ***The following terms are used in this Standard with the meaning specified:***

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

***Cash basis** means a basis of accounting that recognizes transactions and other events only when cash is received or paid.*

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

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

***Cash payments** are cash outflows.*

***Cash receipts** are cash inflows.*

***Control of cash** arises when the entity can use or otherwise benefit from the cash in pursuit of its objectives and can exclude or regulate the access of others to that benefit.*

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

(a) ***Is an entity with the power to contract in its own name;***

(b) ***Has been assigned the financial and operational authority to carry on a business;***

(c) ***Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery;***

(d) ***Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and***

(e) ***Is controlled by a public sector entity.***

Cash Basis of Accounting

1.2.2 The cash basis of accounting recognizes transactions and events only when cash (including cash equivalents) is received or paid by the entity. Financial statements prepared under the cash basis provide readers with information about the sources of cash raised during the period, the purposes for which cash was used and the cash balances at the reporting date. The measurement focus in the financial statements is balances of cash and changes therein. Notes to the financial statements may provide additional information about liabilities, such as payables and borrowings, and some non-cash assets, such as receivables, investments and property, plant and equipment.

Cash Equivalents

1.2.3 Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes. For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition. Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents.

1.2.4 Bank borrowings are generally considered to give rise to cash inflows. However, in some jurisdictions, bank overdrafts which are repayable on demand form an integral part of an entity's cash management. In these circumstances, bank overdrafts are included as a component of cash. A characteristic of such banking arrangements is that the bank balance often fluctuates from being positive to overdrawn.

1.2.5 Cash flows exclude movements between items that constitute cash because these components are part of the cash management of an entity rather than increases or decreases in the cash it controls. Cash management includes the investment of excess cash on hand in cash equivalents.

Cash Controlled by the Reporting Entity

1.2.6 Cash is controlled by an entity when the entity can use the cash for the achievement of its own objectives or otherwise benefit from the cash and exclude or regulate the access of others to that benefit. Cash collected by, or appropriated or granted to, an entity which the entity can use to fund its operating objectives, acquire capital assets or repay its debt is controlled by the entity.

1.2.7 Amounts deposited in the bank account of an entity are controlled by that entity. In some cases, cash which a government entity:

(a) Collects on behalf of its government (or another entity) is deposited in its own bank account before transfer to consolidated revenue or another general government account; and

(b) Is to transfer to third parties on behalf of its government is initially deposited in its own bank account prior to transfer to the authorized recipient.

In these cases, the entity will control the cash for only the period during which the cash resides in its bank account prior to transfer to consolidated revenue or another government controlled bank account, or to third parties. Paragraph 1.4.9 requires the disclosure of cash balances held by an entity at reporting date that are not available for use by the entity or are subject to external restrictions. Additional guidance on the treatment of cash flows that an entity administers on behalf of other entities is included in paragraphs 2.1.15 to 2.1.22 of Part 2 of this Standard.

1.2.8 In some jurisdictions, a government will manage the expenditure of its individual departments and other entities through a centralized treasury function, often referred to as a "single account" basis. Under these arrangements, individual departments and entities do not control their own bank accounts. Rather, government monies are managed by a central entity through a "single" government account or series of accounts. The central entity will make payments on behalf of individual departments and entities after appropriate authorization and documentation. Consequently, individual departments and entities do not control the cash that they have been appropriated or otherwise authorized to expend. In these cases, the expenditures made by individual departments and entities will be reported in a separate column headed "treasury account" (or a similarly described column) in the statement of cash receipts and payments in accordance with the requirements of paragraph 1.3.24(a).

1.2.9 In some cases, the centralized treasury function will be undertaken by an entity which controls the bank account(s) from which payments on behalf of the individual operating departments and other entities are made. In these cases, transfers to and payments from those bank accounts reflect cash receipts and payments which the central entity administers on behalf of the individual operating departments and other entities. Paragraph 1.3.13 specifies that cash receipts and payments which arise from transactions the entity administers on behalf of other entities and which are recognized in the primary financial statements may be reported on a net basis. Paragraph 1.4.9 requires the disclosure of cash balances held by an entity at reporting date that are not available for use by the entity or are subject to external restrictions.

1.3 Presentation and Disclosure Requirements

Definitions

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

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

<u>Materiality:</u> information is material if its omission or misstatement could influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature or size of the item or error judged in the particular circumstances of omission or misstatement.

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

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

1.3.2 Financial statements result from processing large quantities of transactions that are structured by being aggregated into groups according to their nature or function. The final stage in the process of aggregation and classification is the presentation of condensed and classified data that form line items either on the face of the financial statements or in the notes. If a line item is not individually material, it is aggregated with other items either on the face of the financial statements or in the notes. An item that is not sufficiently material to warrant separate presentation on the face of the financial statements may nevertheless be sufficiently material that it should be presented separately in the notes.

1.3.3 The principle of materiality provides that the specific disclosure requirements of International Public Sector Accounting Standards need not be met if the resulting information is not material.

Financial Statements

1.3.4 ***An entity should prepare and present general purpose financial statements which include the following components:***

(a) ***A statement of cash receipts and payments which:***

(i) ***Recognizes all cash receipts, cash payments and cash balances controlled by the entity; and***

(ii) ***Separately identifies payments made by third parties on behalf of the entity in accordance with paragraph 1.3.24 of this Standard;***

(b) ***Accounting policies and explanatory notes; and***

(c) ***When the entity makes publicly available its approved budget, a comparison of budget and actual amounts either as a separate additional financial statement or as a budget column in the statement of cash receipts and payments in accordance with paragraph 1.9.8 of this Standard.***

1.3.5 ***When an entity elects to disclose information prepared on a different basis from the cash basis of accounting as defined in this Standard or otherwise required by paragraphs 1.3.4(a) or 1.3.4(c), such information should be disclosed in the notes to the financial statements.***

1.3.6 The general purpose financial statements comprises the statement of cash receipts and payments and other statements that disclose additional information about the cash receipts, payments and balances controlled by the entity and accounting policies and notes. In accordance with the requirements of paragraph 1.3.4(a)(i) above, only cash receipts, cash payments and cash balances controlled by the reporting entity will be recognized as such in the statement of cash receipts and payments or other statements that might be prepared. In accordance with the requirements of paragraph 1.3.4(c) above, the general purpose financial statements may include a comparison of budget and actual amounts as an additional financial statement.

1.3.7 Paragraph 1.3.24 of this Standard requires disclosure on the face of the statement of cash receipts and payments of certain payments made by third parties on behalf of the reporting entity. Payments made by third parties will not satisfy the definition of cash, cash payments and cash receipts as defined in paragraph 1.2.1 of this Standard and will not be presented as cash receipts and payments controlled by the reporting entity in the statement of cash receipts and payments or other statements that might be prepared by the reporting entity. Paragraph 1.9.17 of this Standard provides that an entity can present a comparison of budget and actual amounts as additional budget columns in the statement of cash receipts and payments only where the financial statements and the budget are prepared on a comparable basis. When the budget and financial statements are not prepared on a comparable basis, a separate statement of comparison of budget and actual amounts is presented.

1.3.8 Notes to the financial statements include narrative descriptions or more detailed schedules or analyses of amounts shown on the face of the financial statements, as well as additional information. They include information required and encouraged to be disclosed by this Standard, and can include other disclosures considered necessary to achieve a fair presentation and enhance accountability.

1.3.9 This Standard does not preclude an entity from including in its general purpose financial statements, statements in addition to the statement of cash receipts and payments as specified in paragraph 1.3.4 above. Consequently, general purpose financial statements may also include additional statements which, for example:

(a) Report cash receipts, cash payments and cash balances for major fund categories such as the consolidated revenue fund;

(b) Provide additional information about the sources and deployment of borrowings and the nature and type of cash payments; or

(c) Provide a comparison of actual and budget amounts.

In accordance with the requirements of paragraph 1.3.5 above, any additional statements will only report cash receipts, payments and balances which are controlled by the entity.

1.3.10 Entities that report using the cash basis of accounting frequently collect information on items that are not recognized under cash accounting. Examples of the type of information that may be collected include details of:

(a) Receivables, payables, borrowings and other liabilities, non-cash assets and accruing revenues and expenses;

(b) Commitments and contingent liabilities; and

(c) Performance indicators and the achievement of service delivery objectives.

1.3.11 Entities preparing general purpose financial statements in accordance with this Standard may disclose such information in the notes to the financial statements where that information is likely to be useful to users. Where such disclosures are made they should be clearly described and readily understandable. If not disclosed in the financial statements themselves, comparisons with budget may also be included in the notes. Part 2 of this Standard encourages inclusion of information about non-cash assets and liabilities and a comparison with budget in general purpose financial statements.

Information to be Presented in the Statement of Cash Receipts and Payments

1.3.12 ***The statement of cash receipts and payments should present the following amounts for the reporting period:***

(a) ***Total cash receipts of the entity showing separately a sub-classification of total cash receipts using a classification basis appropriate to the entity's operations;***

(b) ***Total cash payments of the entity showing separately a sub-classification of total cash payments using a classification basis appropriate to the entity's operations; and***

(c) ***Beginning and closing cash balances of the entity.***

1.3.13 ***Total cash receipts and total cash payments, and cash receipts and cash payments for each sub-classification of cash receipt and payment, should be reported on a gross basis, except that cash receipts and payments may be reported on a net basis when:***

(a) ***They arise from transactions which the entity administers on behalf of other parties and which are recognized in the statement of cash receipts and payments; or***

(b) ***They are for items in which the turnover is quick, the amounts are large, and the maturities are short.***

1.3.14 ***Line items, headings and sub-totals should be presented in the statement of cash receipts and payments when such presentation is necessary to present fairly the entity's cash receipts, cash payments and cash balances.***

1.3.15 This Standard requires all entities to present a statement of cash receipts and payments which discloses beginning and closing cash balances of the entity, total cash receipts and total cash payments over the reporting period, and major sub-classifications thereof. This will ensure that the financial statements provide comprehensive information about the cash balances of the entity and changes therein over the period in a format that is accessible and understandable to users.

1.3.16 Disclosure of information about such matters as the cash balances of the entity, whether cash is generated from taxes, fines, fees, and/or borrowings and whether it was expended to meet operating costs, for the acquisition of capital assets or for the retirement of debt will enhance transparency and accountability of financial reporting. These disclosures will also facilitate more informed analysis and assessments of the entity's current cash resources and the likely sources and sustainability of future cash inflows.

Classification

1.3.17 The sub-classifications (or classes) of total cash receipts and payments which will be disclosed in accordance with paragraphs 1.3.12 and 1.3.14 are a matter of professional judgment. That judgment will be applied in the context of the objective and qualitative characteristics of financial reporting under the cash basis of accounting. Appendix 4 of this Standard summarizes the qualitative characteristics of financial reporting. Total cash receipts may be classified to, for example, separately identify cash receipts from: taxation or appropriation; grants and donations; borrowings; proceeds from the disposal of property, plant and equipment; and other ongoing service delivery and trading activities. Total cash payments may be classified to, for example, separately identify cash payments in respect of: ongoing service delivery activities including transfers to constituents or other governments or entities; debt reduction programs; acquisitions of property, plant and equipment; and any trading activities. Alternative presentations are also possible, for example total cash receipts may be classified by reference to their source and cash payments may be sub-classified by reference to either the nature of the payments or their function or program within the entity, as appropriate.

Line items, headings and sub-totals

1.3.18 Factors to be taken into consideration in determining which line items, headings and sub-totals should be presented within each sub-classification in accordance with the requirements of paragraph 1.3.14 above include: the requirements of other sections of this Standard (for example, paragraph 1.10.8 requires that total external assistance received in cash during the period be disclosed separately on the face of the Statement of Cash Receipts and Payments); assessments of the likely materiality of the disclosures to users; and the extent to which necessary explanations and disclosures are made in the notes to the financial statements. Paragraphs 2.1.23 to 2.1.30 of Part 2 of this Standard set out disclosures of additional major classes of cash flows that an entity is encouraged to make in the notes to the financial statements or in the financial statements themselves. It is likely that in many, but not necessarily all, cases these disclosures will satisfy the requirements of paragraph 1.3.12 above.

Reporting on a net basis

1.3.19 This Standard requires the reporting of cash receipts, payments and balances on a gross basis except in the circumstances identified by paragraph 1.3.13 above. Paragraphs 1.3.20 to 1.3.21 below further elaborate on those circumstances in which reporting on a net basis may be justified.

1.3.20 Governments and government departments and other government entities may administer transactions and otherwise act as agents on behalf of others. These administered and agency transactions may encompass the collection of revenues on behalf of another entity, the transfer of funds to eligible beneficiaries or the safekeeping of monies on behalf of constituents. Examples of such activities may include:

(a) The collection of taxes by one level of government for another level of government, not including taxes collected by a government for its own use as part of a tax sharing arrangement;

(b) The acceptance and repayment of demand deposits of a financial institution;

(c) Funds held for customers by an investment or trust entity;

(d) Rents collected on behalf of, and paid over to, the owners of properties;

(e) Transfers by a government department to third parties consistent with legislation or other government authority; and

(f) Funds administered by a central entity under the “single account” basis for management of government expenditure (as referred to in paragraph 1.2.8).

1.3.21 In many cases, the cash an entity receives in respect of transactions it administers as an agent for others will be deposited in trust accounts for, or directly in the bank account of, the ultimate recipients of the cash. In these cases, the entity will not control the cash it receives in respect of the transactions it administers and these cash flows will not form part of the cash receipts, cash payments or cash balances of the entity. However, in other cases the cash received will be deposited in bank accounts controlled by the entity acting as an agent and the receipt and transfer of that cash will be reported in the statement of cash receipts and payments of the entity.

1.3.22 In some cases, the amounts of the cash flows arising from administered transactions which "pass-through" the bank account of the reporting entity may be large relative to the entity's own transactions, and control may occur for only a short time before the amounts are transferred to the ultimate recipients. This may also be true for other cash flows including for example, advances made for, and the repayment of:

(a) The purchase and sale of investments; and

(b) Other short-term borrowings, for example, those which have a maturity period of three months or less.

1.3.23 The recognition of these transactions on a gross basis may undermine the ability of the financial statements of some governments and government entities to communicate information about cash receipts and cash payments resulting from the entity's own activities. Accordingly, this Standard permits cash receipts and cash payments to be offset and reported on a net basis in the statement of cash receipts and payments in the circumstances identified in paragraph 1.3.13 above.

Payments by third parties on behalf of the entity

1.3.24 ***Where, during a reporting period, a third party directly settles the obligations of an entity or purchases goods and services for the benefit of the entity, the entity should disclose in separate columns on the face of the statement of cash receipts and payments:***

(a) ***Total payments made by third parties which are part of the economic entity to which the reporting entity belongs, showing separately a sub-classification of the sources and uses of total payments using a classification basis appropriate to the entity's operations; and***

(b) ***Total payments made by third parties which are not part of the economic entity to which the reporting entity belongs, showing separately a sub-classification of the sources and uses of total payments using a classification basis appropriate to the entity's operation.***

Such disclosure should only be made when during the reporting period the entity has been formally advised by the third party or the recipient that such payment has been made or has otherwise verified the payment.

1.3.25 Where a government manages the expenditure of its individual departments and other entities through a centralized treasury function or a "single account" arrangement, payments are made on behalf of those departments and entities by a central entity after appropriate authorization and documentation from the department. In these cases, the department or other entity does not control cash inflows, cash outflows and cash balances. However, the department or other entity benefits from the payments being made on its behalf, and knowledge of the amount of these payments is relevant to users in identifying the cash resources the government has applied to the entity's activities during the period. Consistent with paragraph 1.3.24(a) above, the department or other entity reports in a separate column on the face of the statement of cash receipts and payments, the amount of payments made by the central entity on its behalf, and the sources and uses of the amount expended sub-classified on a basis appropriate for the department or other entity. These disclosures will enable users to identify the total amount of payments made, the purposes for which they were made and whether, for example, the payments were made from amounts allocated or appropriated from general revenue or from special purpose funds or other sources.

1.3.26 In some jurisdictions, government departments or other entities may be established with their own bank accounts and will control certain cash inflows, cash outflows and cash balances. In these jurisdictions, government directions or instructions may also require one department or other government entity to settle certain obligations of another department or entity, or to purchase certain goods or services on behalf of another department or entity. Consistent with paragraph 1.3.24(a) above the reporting entity reports in a separate column on the face of the statement of cash receipts and payments the amount, sources and uses of such expenditures made on its behalf during the reporting period. This will assist users in identifying the total cash resources of the economic entity which have been applied to the entity's activities during the reporting period, and the sources and uses of those cash resources.

1.3.27 In some cases, third parties which are not part of the economic entity to which the reporting entity belongs purchase goods or services on behalf of the entity or settle obligations of the entity. For example, a national government may fund the operation of a health or education program of an independent provincial or municipal government by directly paying service providers and acquiring and transferring to the other government the necessary supplies during the period. Similarly, a national government or independent aid agency may pay a construction company directly for building a road for a particular government rather than providing the funds directly to the government itself. These payments may be made by way of a grant or other aid, or as a loan which is to be repaid. In these cases, the provincial or municipal government does not receive cash (including cash equivalents) directly from, or gain control of a bank account or similar facility established for its benefit by, the other entity. Therefore, the amount settled or paid on its behalf does not constitute "cash" as defined in this

Standard. However, the government benefits from the cash payments being made on its behalf.

1.3.28 Paragraph 1.3.24(b) above requires that an entity report in a separate column on the face of its statement of cash receipts and payments, the amount, sources and uses of expenditures made by third parties which are not part of the economic entity to which it belongs. This will enable users to identify the total cash resources being applied to the entity's activities during the reporting period, and the extent to which those resources are provided from parties which are, and which are not, part of the government to which the reporting entity belongs. In some cases, as at reporting date an entity may not be aware that payments have been made on their behalf by third parties during the reporting period. This may occur where the entity has not been formally advised of the third party payment or cannot otherwise verify that an expected payment has occurred. Paragraph 1.3.24 above requires that third party payments only be disclosed on the face of the statement of cash receipts and payments when during the reporting period the entity has been formally advised that such payments have been made or otherwise verifies their occurrence.

1.3.29 The sub-classifications (or classes) of sources and uses of third party payments which will be disclosed in accordance with paragraphs 1.3.24(a) and 1.3.24(b) are a matter of professional judgment. The factors that will be considered in exercising that judgment are outlined in paragraph 1.3.17.

Accounting Policies and Explanatory Notes

Structure of the Notes

1.3.30 ***The notes to the financial statements of an entity should:***

(a) ***Present information about the basis of preparation of the financial statements and the specific accounting policies selected and applied for significant transactions and other events; and***

(b) ***Provide additional information which is not presented on the face of the financial statements but is necessary for a fair presentation of the entity's cash receipts, cash payments and cash balances.***

1.3.31 ***Notes to the financial statements should be presented in a systematic manner. Each item on the face of the statement of cash receipts and payments and other financial statements should be cross referenced to any related information in the notes.***

Selection and Disclosure of Accounting Policies

1.3.32 ***General purpose financial statements should present information that is:***

(a) ***Understandable;***

(b) ***Relevant to the decision-making and accountability needs of users; and***

(c) ***Reliable in that it:***

   (i) ***Represents faithfully the cash receipts, cash payments and cash balances of the entity and the other information disclosed;***

   (ii) ***Is neutral, that is, free from bias; and***

   (iii) ***Is complete in all material respects.***

1.3.33 The quality of information provided in general purpose financial statements determines the usefulness of that statement to users. Paragraph 1.3.32 requires the development of accounting policies to ensure that the financial statements provide information that meets a number of qualitative characteristics. Appendix 4 of this Standard summarizes the qualitative characteristics of financial reporting. The appendix also notes that the timeliness of information may impact upon both the relevance and reliability of the financial information. The maintenance of complete and accurate accounting records during the reporting period is essential for timely production of the general purpose financial statement.

1.3.34 ***The accounting policies section of the notes to the financial statements should describe each specific accounting policy that is necessary for a proper understanding of the financial statements, including the extent to which the entity has applied any transitional provisions in this Standard.***

1.3.35 ***Inappropriate accounting treatments are not rectified either by disclosure of the accounting policies used, or by notes or explanatory material.***

1.3.36 In deciding whether a specific accounting policy should be disclosed, management considers whether disclosure would assist users in understanding the way in which transactions and events are reflected in the reported cash receipts, payments and balances. An accounting policy may be significant even if amounts shown for current and prior periods are not material. Paragraph 1.3.4 of this Standard specifies that general purpose financial statements include accounting policies and explanatory notes. Consequently, the requirements of paragraph 1.3.34 above also apply to notes to the financial statements.

1.3.37 ***Where an entity elects to include in its financial statements any disclosures encouraged in Part 2 of this Standard, those disclosures should comply with the requirements of paragraph 1.3.32 above.***

1.3.38 Part 2 of this Standard encourages the disclosure of additional information in notes to the financial statements. Where such disclosures are made, they will need to be understandable and to satisfy the other qualitative characteristics of financial information.

1.4 General Considerations

Reporting Period

1.4.1 ***The general purpose financial statements should be presented at least annually. When, in exceptional circumstances, an entity's reporting date changes and the annual financial statements are presented for a period longer or shorter than one year, an entity should disclose in addition to the period covered by the financial statements:***

(a) ***The reason(s) for a period other than one year being used; and***

(b) ***the fact that comparative amounts may not be comparable.***

1.4.2 The reporting date is the date of the last day of the reporting period to which the financial statements relate. In exceptional circumstances an entity may be required to, or decide to, change its reporting date to, for example, align the reporting cycle more closely with the budgeting cycle. When this is the case, it is important that the reason for the change in reporting date is disclosed and that users are aware that the amounts shown for the current period and the comparative amounts are not comparable.

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

Timeliness

1.4.4 The usefulness of the financial statements are impaired if they are not made available to users within a reasonable period after the reporting date. An entity should be in a position to issue its financial statements within six months of the reporting date, although a timeframe of no more than three months is strongly encouraged. Ongoing factors such as the complexity of an entity's operations are not sufficient reason for failing to report on a timely basis. More specific deadlines are dealt with by legislation and regulations in many jurisdictions.

Authorization Date

1.4.5 ***An entity should disclose the date when the financial statements were authorized for issue and who gave that authorization. If another body has the power to amend the financial statements after issuance, the entity should disclose that fact.***

1.4.6 The authorization date is the date on which the financial statements have received approval from the individual or body with the authority to finalize those statements for issue. It is important for users to know when the financial statements were authorized for issue, because the financial statements do not reflect events after this date. It is also important for users to know of the rare circumstances in which any persons or organizations have the authority to amend the financial statements after issuance. Examples of individuals or bodies that may have the power to amend the financial statements after issuance are Ministers, the government of which the entity forms part, Parliament or an elected body of representatives. If changes are made, the amended financial statements are a new set of financial statements.

Information about the Entity

1.4.7 ***An entity should disclose the following if not disclosed elsewhere in information published with the financial statements:***

(a) ***The domicile and legal form of the entity, and the jurisdiction within which it operates;***

(b) ***A description of the nature of the entity's operations and principal activities;***

(c) ***A reference to the relevant legislation governing the entity's operations, if any; and***

(d) ***The name of the controlling entity and the ultimate controlling entity of the economic entity (where applicable, if any).***

1.4.8 The disclosure of the information required by paragraph 1.4.7 will enable users to identify the nature of the entity's operations and gain an understanding of the legislative and institutional environment within which it operates. This is necessary for accountability purposes and will assist users in understanding and evaluating the financial statements of the entity.

Restrictions on Cash Balances and Access to Borrowings

1.4.9 ***An entity should disclose in the notes to the financial statements together with a commentary, the nature and amount of:***

(a) ***Significant cash balances that are not available for use by the entity;***

(b) ***Significant cash balances that are subject to external restrictions; and***

(c) ***Undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities.***

1.4.10 Cash balances held by an entity would not be available for use by the entity when, for example, a controlled entity operates in a country where exchange controls or other legal restrictions apply and the balances are not available for general use by the controlling entity or other controlled entities.

1.4.11 Cash balances controlled by an entity may be subject to restrictions which limit the purpose or timing of their use. This situation often exists when an entity receives a grant or donation which must be used for a specific purpose. It may also exist where, at reporting date, an entity holds in its own bank accounts cash it has collected for other parties in its capacity as an agent but not yet transferred to those parties. Although these balances are controlled by the entity and reported as a cash balance of the entity, separate disclosure of the amount of such items is helpful to readers.

1.4.12 Undrawn borrowing facilities represent a potential source of cash for an entity. Disclosure of the amount of these facilities by significant type allows readers to assess the availability of such cash, and the extent to which the entity has made use of them during the reporting period.

Consistency of Presentation

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

(a) ***A significant change in the nature of the operations of the entity or a review of its financial statements presentation demonstrates that the change will result in a more appropriate presentation of events or transactions; or***

(b) ***A change in presentation is required by a future amendment to this Standard.***

1.4.14 A major restructuring of service delivery arrangements; the creation of a new, or termination of a major existing, government entity; a significant acquisition or disposal; or a review of the overall presentation of the entity's general purpose financial statements might suggest that the statement of cash receipts and payments or other individual financial statements should be presented differently. For example, a government may dispose of a government savings bank that represents one of its most significant controlled entities and the remaining economic entity conducts mainly administrative and policy advice services. In this case, the presentation of the financial statements identifying a financial institution as a principal activity of the government is unlikely to be relevant.

1.4.15 Only if the revised structure is likely to continue, or if the benefit of an alternative presentation is clear, should an entity change the presentation of its financial statements. When such changes in presentation are made, an entity reclassifies its comparative information in accordance with paragraph 1.4.19. Where an entity complies with this International Public Sector Accounting Standard, a change in presentation to comply with national requirements is permitted as long as the revised presentation is consistent with the requirements of this Standard.

Comparative Information

1.4.16 ***Unless a provision of this Standard permits or requires otherwise, comparative information should be disclosed in respect of the previous period for all numerical information required by this Standard to be disclosed in the financial statements, except in respect of the financial statements for the reporting period to which this Standard is first applied. Comparative information should be included in narrative and descriptive information when it is relevant to an understanding of the current period's financial statements.***

1.4.17 This Standard requires the presentation of a statement of cash receipts and payments and specifies certain disclosures that are required to be made in that statement and notes thereto. This Standard does not preclude the preparation of additional financial statements. Part 2 of this Standard encourages certain additional disclosures. Where financial statements in addition to the statement of cash receipts and payments are prepared or disclosures encouraged by Part 2 of this Standard are made, the disclosure of comparative information is also encouraged.

1.4.18 In some cases, narrative information provided in the financial statements for the previous period(s) continues to be relevant in the current period. For example, details of a legal dispute, the outcome of which was uncertain at the last reporting date and is yet to be resolved, may be disclosed in the current period. Users benefit from knowing that the uncertainty existed at the last reporting date, and the steps that have been taken during the period to resolve the uncertainty.

1.4.19 ***When the presentation or classification of items required to be disclosed in the financial statements is amended, comparative amounts should be reclassified, unless it is impracticable to do so, to ensure comparability with the current period, and the nature, amount of, and reason for any reclassification should be disclosed. When it is impracticable to reclassify comparative amounts, an entity should disclose the reason for not reclassifying and the nature of the changes that would have been made if amounts were reclassified.***

1.4.20 Circumstances may exist when it is impracticable to reclassify comparative information to achieve comparability with the current period. For example, data may not have been collected in the previous period(s) in a way which allows reclassification, and it may not be practicable to recreate the information. In such circumstances, the nature of the adjustments to comparative amounts that would have been made is disclosed.

Identification of Financial Statements

1.4.21 ***The financial statements should be clearly identified and distinguished from other information in the same published document.***

1.4.22 This Standard applies only to the financial statements, and not to other information presented in an annual report or other document. Therefore, it is important that users are able to distinguish information that is prepared using this Standard from other information that may be useful to users but that is not the subject of this Standard.

1.4.23 ***Each component of the financial statements should be clearly identified. In addition, the following information should be prominently displayed and repeated when it is necessary for a proper understanding of the information presented:***

(a) ***The name of the reporting entity or other means of identification;***

(b) ***Whether the financial statements cover the individual entity or the economic entity;***

(c) ***The reporting date or the period covered by the financial statements, whichever is appropriate to the related component of the financial statements;***

(d) ***The reporting currency; and***

(e) ***The level of precision used in the presentation of figures in the financial statements.***

1.4.24 The requirements in paragraph 1.4.23 are normally met by presenting page headings and abbreviated column headings on each page of the financial statements. Judgment is required in determining the best way of presenting such information. For example, when the financial statements are read electronically, separate pages may not be used. In such cases, the items identified in paragraph 1.4.23 are presented frequently enough to ensure a proper understanding of the information given.

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

1.5 Correction of Errors

1.5.1 ***When an error arises in relation to a cash balance reported in the financial statements, the amount of the error that relates to prior periods should be reported by adjusting the cash at the beginning of the period. Comparative information should be restated, unless it is impracticable to do so.***

1.5.2 ***An entity should disclose in the notes to the financial statements the following:***

(a) ***The nature of the error;***

(b) ***The amount of the correction; and***

(c) ***The fact that comparative information has been restated or that it is impracticable to do so.***

1.5.3 Errors in the preparation of the financial statements of one or more prior periods may be discovered in the current period. Errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, fraud or oversights. When an error is identified in respect of a previous period, the opening balance of cash is adjusted to correct the error and the financial statements, including the comparative information for prior periods, is presented as if the error had been corrected in the period in which it was made. An explanation of the error and its adjustment is included in the notes.

1.5.4 The restatement of comparative information does not necessarily give rise to the amendment of financial statements which have been approved by the governing body or registered or filed with regulatory authorities. However, national laws may require the amendment of such financial statements.

1.5.5 This Standard requires the presentation of a statement of cash receipts and payments, and does not preclude the presentation of other financial statements. Where financial statements in addition to the statement of cash receipts and payments are presented, the requirements in paragraphs 1.5.1 and 1.5.2 for correction of errors will also apply to those statements.

1.6 Consolidated Financial Statements

Definitions

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

Consolidated financial statements are the financial statements of an economic entity presented as that of a single entity.

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

Controlled entity is an entity that is under the control of another entity (known as the controlling entity).

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

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

Economic Entity

1.6.2 The term "economic entity" is used in this Standard to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities.

1.6.3 Other terms sometimes used to refer to an economic entity include "administrative entity," "financial reporting entity," "consolidated entity" and "group."

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

Scope of Consolidated Financial Statements

1.6.5 ***A controlling entity, other than a controlling entity identified in paragraphs 1.6.7 and 1.6.8, should issue consolidated financial statements which consolidates all controlled entities, foreign and domestic, other than those referred to in paragraph 1.6.6.***

1.6.6 ***A controlled entity should be excluded from consolidation when it operates under severe external long-term restrictions which prevent the controlling entity from benefiting from its activities.***

1.6.7 ***A controlling entity that is a wholly owned controlled entity need not present consolidated financial statements provided users of such financial statements are unlikely to exist or their information needs are met by the controlling entity's consolidated financial statements.***

1.6.8 ***A controlling entity that is virtually wholly owned need not present consolidated financial statements provided the controlling entity obtains the approval of the owners of the minority interest.***

1.6.9 Users of the financial statements of a government or other public sector controlling entity are usually concerned with, and need to be informed about, the cash resources controlled by the economic entity as a whole. This need is served by consolidated financial statements which present financial information about the economic entity as a single entity without regard for the legal boundaries of the separate legal entities.

1.6.10 Paragraph 1.3.4 of this Standard requires that a reporting entity prepare a statement of cash receipts and payments. Consistent with the requirements of paragraph 1.6.5 above, the statement of cash receipts and payments prepared by a government or other public sector reporting entity which is a controlling entity, will consolidate the cash receipts, cash payments and cash balances of all the entities it controls. The note disclosures required by Part 1 of this

Standard will also be presented on a consolidated basis. Appendix 5 of this Statement illustrates the application of the concept of control in determining the financial reporting entity.

1.6.11 This Standard does not preclude the preparation of financial statements additional to the statement of cash receipts and payments. Those additional statements may, for example, disclose additional information about receipts and payments related to certain fund groups or provide additional details about certain types of cash flows. Part 2 of this Standard identifies additional disclosures that an entity is encouraged to make. The additional statements and disclosures will also report consolidated information where appropriate.

1.6.12 For financial reporting purposes, the reporting entity (financial reporting entity) may consist of a number of controlled entities including government departments, agencies and Government Business Enterprises (GBEs). Determining the scope of the financial reporting entity can be difficult due to the large number of potential entities. For this reason, financial reporting entities are often determined by legislation. In some cases, the financial reporting entity required by this Standard may differ from the reporting entity specified by legislation and additional disclosures may be necessary to satisfy the legislative reporting requirements.

1.6.13 A controlling entity that is itself wholly owned by another entity (such as a government agency which is wholly owned by the government), is not required to present consolidated financial statements when such statements are not required by its controlling entity and the needs of other users may be best served by the consolidated financial statements of its controlling entity. However, in the public sector, many controlling entities that are either wholly owned or virtually wholly owned represent key sectors or activities of a government. In these cases, the information needs of certain users may not be served by the presentation of a consolidated financial statement at a whole-of-government level alone, and the purpose of this Standard is not to exempt such entities from preparing consolidated financial statements. In many jurisdictions, governments have acknowledged this and have legislated the financial reporting requirements of such entities.

1.6.14 In some jurisdictions, a controlling entity which is virtually wholly owned by another entity (such as a government enterprise which has some minor ownership from the private sector) is also exempted from presenting consolidated financial statements if the controlling entity obtains the approval of the owners of the minority interest. Virtually wholly owned is often taken to mean that the controlling entity owns 90% or more of the voting power. For the purpose of this Standard, the minority interest is that part of a controlled entity attributable to interests which are not owned, directly or indirectly through controlled entities, by the controlling entity.

1.6.15 In some instances, an economic entity will include a number of intermediate controlling entities. For example, whilst a department of health may be the controlling entity, there may be intermediate controlling entities at the local or regional health authority level. Accountability and reporting requirements in each jurisdiction may specify which entities are required to (or exempted from the requirement to) prepare a consolidated financial statement. Where there is no requirement for an intermediate controlling entity to prepare consolidated financial statements but users of general purpose financial statements of the economic entity are likely to exist, intermediate controlling entities are encouraged to prepare and publish such a statement.

Consolidation Procedures

1.6.16 ***The following consolidation procedures apply:***

(a) ***Cash balances and cash transactions between entities within the economic entity should be eliminated in full;***

(b) ***When the financial statements used in a consolidation are drawn up to different reporting dates, adjustments should be made for the effects of significant cash transactions that have occurred between those dates and the date of the controlling entity's financial statements. In any case, the difference between the reporting dates should be no more than three months; and***

(c) ***Consolidated financial statements should be prepared using uniform accounting policies for like cash transactions. If it is not practicable to use uniform accounting policies in preparing the consolidated financial statements, that fact should be disclosed together with the proportions of the items in the consolidated financial statements to which the different accounting policies have been applied.***

1.6.17 The consolidation procedures outlined in paragraph 1.6.16 provide the basis for preparing consolidated financial statements for all the entities within the economic entity as a single economic unit.

1.6.18 The consolidated financial statements should only reflect transactions between the economic entity and other entities external to it. Accordingly, transactions between entities within the economic entity are eliminated to avoid double-counting. For example, a government department may sell a physical asset to another government department. Because the net cash effect on the whole-of-government reporting entity is zero, this transaction needs to be eliminated to avoid overstating the cash receipts and cash payments of the whole-of-government reporting entity. A government entity may hold funds with a public sector financial institution. These balances would be eliminated at the whole-of-government level because they represent balances within the economic entity. Similarly, a GBE operating overseas may make a payment to a government department which remains in transit at the reporting date. In this case, failure to eliminate the transaction would result in understating the cash balance of the economic entity and overstating its cash payments.

1.6.19 Individual entities within the economic entity may adopt different policies for the classification of cash receipts and cash payments and the presentation of their financial statements. Cash receipts or cash payments arising from like transactions are classified and presented in a uniform manner in the consolidated financial statements where practicable.

Consolidation Disclosures

1.6.20 ***The following disclosures should be made in consolidated financial statements:***

(a) ***A listing of significant controlled entities including the name, the jurisdiction in which the controlled entity operates (when it is different from that of the controlling entity); and***

(b) ***The reasons for not consolidating a controlled entity.***

Transitional Provisions

1.6.21 Controlling entities that adopt this Standard may have large numbers of controlled entities with significant volumes of transactions between those entities. Accordingly, it may be difficult to identify all the transactions and balances that need to be eliminated for the purpose of preparing the consolidated financial statements of the economic entity. For this reason, paragraph 1.8.2 provides relief, during the transitional period, from the requirement to eliminate all cash balances and transactions between entities within the economic entity. However, paragraph 1.8.3 requires that entities which apply the transitional provision should disclose the fact that not all balances and transactions between entities within the economic entity have been eliminated.

1.7 Foreign Currency

Definitions

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

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

***Exchange difference** is the difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.*

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

***Foreign currency* is a currency other than the reporting currency of an entity.**

***Reporting currency* is the currency used in presenting the financial statements.**

Treatment of Foreign Currency Cash Receipts, Payments and Balances

1.7.2 ***Cash receipts and payments arising from transactions in a foreign currency should be recorded in an entity's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the receipts and payments.***

1.7.3 ***Cash balances held in a foreign currency should be reported using the closing rate.***

1.7.4 ***The cash receipts and cash payments of a foreign controlled entity should be translated at the exchange rates between the reporting currency and the foreign currency at the dates of the receipts and payments.***

1.7.5 ***An entity should disclose the amount of exchange differences included as reconciling items between opening and closing cash balances for the period.***

1.7.6 ***When the reporting currency is different from the currency of the country in which the entity is domiciled, the reason for using a different currency should be disclosed. The reason for any change in the reporting currency should also be disclosed.***

1.7.7 Governments and government entities may have transactions in foreign currencies such as borrowing an amount of foreign currency or purchasing goods and services where the purchase price is designated as a foreign currency amount. They may also have foreign operations and transfer cash to and receive cash from those foreign operations. In order to include foreign currency transactions and foreign operations in financial statements the entity must express cash receipts, payments and balances in reporting currency terms.

1.7.8 Unrealized gains and losses arising from changes in foreign currency exchange rates are not cash receipts and payments. However, the effect of exchange rate changes on cash held in a foreign currency is reported in the statement of cash receipts and payments in order to reconcile cash at the beginning and the end of the period. This amount is presented separately from cash receipts and payments and includes the differences, if any, had those cash receipts payments and balances been reported at end-of-period exchange rates.

1.8 Effective Date of Sections 1 to 7 of Part 1 and Transitional Provisions

Effective Date

1.8.1 ***Sections 1 to 7 of Part 1 of this International Public Sector Accounting Standard become effective for annual financial statements covering periods beginning on or after 1 January 2004. Earlier application is encouraged.***

Transitional Provisions—Consolidated Financial Statements

1.8.2 ***Entities are not required to comply with the requirement in paragraph 1.6.16(a) concerning the elimination of cash balances and transactions between entities within the economic entity for reporting periods beginning on a date within three years following the date of first adoption of this Standard.***

1.8.3 ***Where entities apply the transitional provision in paragraph 1.8.2, they should disclose the fact that not all balances and transactions between entities within the economic entity have been eliminated.***

1.9 Presentation of Budget Information in Financial Statements

Definitions

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

<u>Accounting basis</u> means the accrual or cash basis of accounting as defined in the accrual basis International Public Sector Accounting Standards and the Cash Basis International Public Sector Accounting Standard.

<u>Annual budget</u> means an approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.

<u>Appropriation</u> is an authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority.

<u>Approved budget</u> means the expenditure authority derived from laws, appropriation bills, government ordinances and other decisions related to the anticipated revenue or receipts for the budgetary period.

<u>Budgetary basis</u> means the accrual, cash or other basis of accounting adopted in the budget that has been approved by the legislative body.

***Comparable basis** means the actual amounts presented on the same accounting basis, same classification basis, for the same entities and for the same period as the approved budget.*

***Final budget** is the original budget adjusted for all reserves, carry over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative or similar authority, changes applicable to the budget period.*

***multiyear budget** is an approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.*

***Original budget** is the initial approved budget for the budget period.*

Approved Budgets

1.9.2 An approved budget as defined by this Standard reflects the anticipated revenues or receipts expected to arise in the annual or multiyear budget period based on current plans and the anticipated economic conditions during that budget period, and expenses or expenditures approved by a legislative body, being the legislature or other relevant authority. An approved budget is not a forward estimate or a projection based on assumptions about future events and possible management actions which are not necessarily expected to take place. Similarly, an approved budget differs from prospective financial information which may be in the form of a forecast, a projection or a combination of both – for example, a one year forecast plus a five year projection.

1.9.3 In some jurisdictions, budgets may be signed into law as part of the approval process. In other jurisdictions, approval may be provided without the budget becoming law. Whatever the approval process, the critical feature of approved budgets is that the authority to withdraw funds from the government treasury or similar body for agreed and identified purposes is provided by a higher legislative body or other appropriate authority. The approved budget establishes the expenditure authority for the specified items. The expenditure authority is generally considered the legal limit within which an entity must operate. In some jurisdictions, the approved budget for which the entity will be held accountable may be the original budget and in others it may be the final budget.

1.9.4 If a budget is not approved prior to the beginning of the budget period, the original budget is the budget that was first approved for application in the budget year.

Original and Final Budget

1.9.5 The original budget may include residual appropriated amounts automatically carried over from prior years by law. For example, governmental budgetary processes in some jurisdictions include a legal provision that requires the automatic rolling forward of appropriations to cover prior year commitments. Commitments encompass possible future liabilities based on a current contractual agreement. In some jurisdictions, they may be referred to as obligations or encumbrances and include outstanding purchase orders and contracts where goods or services have not yet been received.

1.9.6 Supplemental appropriations may be necessary where the original budget did not adequately envisage expenditure requirements arising from, for example, war or natural disasters. In addition, there may be a shortfall in budgeted receipts during the period, and internal transfers between budget heads or line items may be necessary to accommodate changes in funding priorities during the fiscal period. Consequently, the funds allotted to an entity or activity may need to be cut back from the amount originally appropriated for the period in order to maintain fiscal discipline. The final budget includes all such authorized changes or amendments.

Actual Amounts

1.9.7 This Standard uses the term actual or actual amounts to describe the amounts that result from execution of the budget. In some jurisdictions, budget out-turn, budget execution or similar terms may be used with the same meaning as actual or actual amounts.

Presentation of a Comparison of Budget and Actual Amounts

1.9.8 ***Subject to the requirements of paragraph 1.9.17, an entity that makes publicly available its approved budget(s) shall present a comparison of the budget amounts for which it is held publicly accountable and actual amounts either as a separate additional financial statement or as additional budget columns in the statement of cash receipts and payments currently presented in accordance with this Standard. The comparison of budget and actual amounts shall present separately for each level of legislative oversight:***

(a) ***The original and final budget amounts;***

(b) ***The actual amounts on a comparable basis; and***

(c) ***By way of note disclosure, an explanation of material differences between the budget for which the entity is held publicly accountable and actual amounts, unless such explanation is included in other public documents issued in conjunction with the financial statements, and a cross reference to those documents is made in the notes.***

Scope

1.9.9 This Standard applies to all entities that are required to, or elect to, make publicly available their approved budget(s). This Standard does not require approved budgets to be made publicly available, nor does it require that the financial statements disclose information about, or include comparisons with, approved budgets which are not made publicly available.

1.9.10 In some cases, approved budgets will be compiled to encompass all the activities controlled by a public sector entity. In other cases, separate approved budgets may be required to be made publicly available for certain activities, groups of activities or entities included in the financial statements of a government or other public sector entity. This may occur where, for example, a government's financial statements encompass government agencies or programs that have operational autonomy and prepare their own budgets, or where a budget is prepared only for the general government sector of the whole-of-government. This Standard applies to all entities which present financial statements when approved budgets for the entity, or components thereof, are made publicly available.

Comparison of Budget and Actual Amounts

1.9.11 Presentation in the financial statements of the original and final budget amounts and actual amounts on a comparable basis with the budget, which is made publicly available, will complete the accountability cycle by enabling users of the financial statements to identify whether resources were obtained and used in accordance with the approved budget. Differences between the actual amounts and the budget amounts, whether original or final budget (often referred to as the "variance" in accounting), may also be presented in the financial statements for completeness.

1.9.12 An explanation of the material differences between actual amounts and the budget amounts will assist users in understanding the reasons for material departures from the approved budget for which the entity is held publicly accountable.

1.9.13 An entity may be required, or may elect, to make publicly available its original budget, its final budget or both its original and final budget. In circumstances where both original and final budget are required to be made publicly available, the legislation, regulation or other authority will often provide guidance on whether explanation of material differences between actual and the original budget amounts, or actual and the final budget amounts, is required in accordance with paragraph 1.9.8(c). In the absence of any such guidance, material differences may be determined by reference to, for example, differences between actual and original budget to focus on performance against original budget, or differences between actual and final budget to focus on compliance with the final budget.

1.9.14 In many cases, the final budget amount and the actual amount will be the same. This is because budget execution is monitored over the reporting period and the original budget progressively revised to reflect changing conditions, changing circumstances and experiences during the reporting period. Paragraph 1.9.23 of this Standard requires the disclosure of an explanation of the reasons for changes between the original and final budget. That disclosure, together with the disclosures required by paragraph 1.9.8 above, will ensure that entities which make publicly available their approved budget(s) are held publicly accountable for their performance against, and compliance with, the relevant approved budget.

1.9.15 Management discussion and analysis, operations review or other public reports which provide commentary on the performance and achievements of the entity during the reporting period, including explanations of any material differences from budget amounts, are often issued in conjunction with the financial statements. In accordance with paragraph 1.9.8(c) of this Standard, explanation of material differences between actual and budget amounts will be included in notes to the financial statements unless included in other public reports or documents issued in conjunction with the financial statements, and the notes to the financial statements identify the reports or documents in which the explanation can be found.

1.9.16 Where approved budgets are only made publicly available for some of the entities or activities included in the financial statements, the requirements of paragraph 1.9.8 will apply to only the entities or activities reflected in the approved budget. This means that where, for example, a budget is prepared only for the general government sector of a whole-of-government reporting entity, the disclosures required by paragraph 1.9.8 will be made only in respect of the general government sector of the government.

Presentation

1.9.17 ***An entity shall present a comparison of budget and actual amounts as additional budget columns in the statement of cash receipts and payments only where the financial statements and the budget are prepared on a comparable basis.***

1.9.18 Comparisons of budget and actual amounts may be presented in a separate financial statement ("statement of comparison of budget and actual amounts" or a similarly titled statement). Alternatively, where the financial statements and the budget are prepared on a comparable basis—that is, on the same basis of accounting for the same entity and reporting period, and adopt the same classification structure—additional columns may be added to the statement of cash receipts and payments presented in accordance with this Standard. These additional columns will identify original and final budget amounts and, if the entity so chooses, differences between the budget and actual amounts.

1.9.19 When the budget and financial statements are not prepared on a comparable basis, a separate statement of comparison of budget and actual amounts is presented. In these cases, to ensure that readers do not misinterpret financial information which is prepared on different bases, the financial statements could usefully clarify that the budget and the accounting bases differ and the statement of comparison of budget and actual amounts is prepared on the budget basis.

Level of Aggregation

1.9.20 Budget documents may provide great detail about particular activities, programs or entities. These details are often aggregated into broad classes under common budget heads, budget classifications or budget headings for presentation to, and approval by, the legislature or other authoritative body. The disclosure of budget and actual information consistent with those broad classes and budget heads or headings will ensure that comparisons are made at the level of legislative or other authoritative body oversight identified in the budget document(s).

1.9.21 In some cases, the detailed financial information included in approved budgets may need to be aggregated for presentation in financial statements in accordance with the requirements of this Standard. Such aggregation may be necessary to avoid information overload and to reflect relevant levels of legislative or other authoritative body oversight. Determining the level of aggregation will involve professional judgment. That judgment will be applied in the context of the objective of this Standard and the qualitative characteristics of financial reporting as identified in paragraph 1.3.32 of this Standard.

1.9.22 Additional budget information, including information about service achievements, may be presented in documents other than financial statements. Part 2 of this Standard encourages the inclusion in the financial statements of a cross reference to such documents.

Changes from Original to Final Budget

1.9.23 ***An entity shall present an explanation of whether changes between the original and final budget are a consequence of reallocations within the budget, or of other factors, either:***

(a) ***By way of note disclosure in the financial statements; or***

(b) ***In a report issued before, at the same time as, or in conjunction with the financial statements, and shall include a cross reference to the report in the notes to the financial statements.***

1.9.24 The final budget includes all changes approved by legislative actions or other designated authority to revise the original budget. Consistent with the requirements of this Standard, notes to the financial statements or a separate report issued before, in conjunction with or at the same time as the financial statements, will include an explanation of changes between the original and final budget. That explanation will include whether, for example, changes arise as a consequence of reallocations within the original budget parameters or as a consequence of other factors, such as changes in the overall budget parameters, including changes in government policy. Such disclosures are often made in a management discussion and analysis or similar report on operations issued in conjunction with, but not as part of, the financial statements. Such disclosures may also be included in budget out-turn reports issued by governments to report on budget execution. Where such disclosures are made in a separate report rather than in the notes to the financial statements, the notes will include a cross reference to that report.

Comparable Basis

1.9.25 ***All comparisons of budget and actual amounts shall be presented on a comparable basis to the budget.***

1.9.26 The comparison of budget and actual amounts will be presented on the same accounting basis (accrual, cash or other basis), same classification basis and for the same entities and period as for the approved budget. This will ensure that the disclosure of information about compliance with the budget in the financial statements is on the same basis as the budget itself. In some cases, this may mean presenting a budget and actual comparison on a different basis of accounting, for a different group of activities, and with a different presentation or classification format than that adopted for the financial statements.

1.9.27 Financial statements consolidate entities and activities controlled by the entity. As noted in paragraph 1.9.10, separate budgets may be approved and made publicly available for individual entities or particular activities that make up the consolidated financial statements. Where this occurs, the separate budgets may be recompiled for presentation in the financial statements in accordance with the requirements of this Standard. Where such recompilation occurs, it will not involve changes or revisions to approved budgets. This is because this Standard requires a comparison of actual amounts with the approved budget amounts.

1.9.28 Entities may adopt different bases of accounting for the preparation of their financial statements and for their approved budgets. For example, in some, albeit rare, cases a government or government agency may adopt the cash basis for its financial statements and the accrual basis for its budget. In addition, budgets may focus on, or include information about, commitments to expend funds in the future and changes in those commitments, while the financial statements will report cash receipts and payments and balances thereof. However, the budget entity and financial reporting entity will often be the same. Similarly, the period for which the budget is prepared and the classification basis adopted for the budget will often be reflected in financial statements. This will ensure that the accounting system records and reports financial information in a manner which facilitates the comparison of budget and actual data for management and for accountability purposes – for example, for monitoring progress of execution of the budget during the budget period and for reporting to the government, the public and other users on a relevant and timely basis.

1.9.29 In some jurisdictions, budgets may be prepared on a cash or accrual basis consistent with a statistical reporting system that encompasses entities and activities different from those included in the financial statements. For example, budgets prepared to comply with a statistical reporting system may focus on the general government sector and encompass only entities fulfilling the "primary" or "non-market" functions of government as their major activity, while financial statements report on all activities controlled by a government, including the business activities of the government.

1.9.30 In statistical reporting models, the general government sector may comprise national, state/provincial and local government levels. In some jurisdictions, the national government may control state/provincial and local governments, consolidate those governments in its financial statements and develop, and require to be made publicly available, an approved budget that encompasses all three levels of government. In these cases, the requirements of this Standard will apply to the financial statements of those national governmental entities. However, where a national government does not control state or local governments, its financial statement will not consolidate state/provincial or local governments. Rather, separate financial statements are prepared for each level of government. The requirements of this Standard will only apply to the financial statements of governmental entities when approved budgets for the entities and activities they control, or subsections thereof, are made publicly available.

Multiyear Budgets

1.9.31 Some governments and other entities approve and make publicly available multiyear budgets, rather than separate annual budgets. Conventionally, multiyear budgets comprise a series of annual budgets or annual budget targets. The approved budget for each component annual period reflects the application of the budgetary policies associated with the multiyear budget for that component period. In some cases, the multiyear budget provides for a roll forward of unused appropriations in any single year.

1.9.32 Governments and other entities with multiyear budgets may take different approaches to determining their original and final budget depending on how their budget is passed. For example, a government may pass a biennial budget that contains two approved annual budgets, in which case an original and final approved budget for each annual period will be identifiable. If unused appropriations from the first year of the biennial budget are legally authorized to be spent in the second year, the "original" budget for the second year period will be increased for these "carry over" amounts. In the rare cases in which a government passes a biennial or other multi-period budget that does not specifically separate budget amounts into each annual period, judgment may be necessary in identifying which amounts are attributable to each annual period for determining the annual budget for the purposes of this Standard. For example, the original and final approved budget for the first year of a biennial period will encompass any approved capital acquisitions for the biennial period that occurred during the first year, together with the amount of the recurring revenue and expenditure items attributable to that year. The unexpended amounts from the first annual period would then be included in the "original" budget for the second annual period and that budget together with any amendments thereto would form the final budget for the second year. Part 2 of this Standard encourages disclosure of the relationship between budget and actual amounts during the budget period.

Note Disclosures of Budgetary Basis, Period and Scope

1.9.33 ***An entity shall explain in notes to the financial statements the budgetary basis and classification basis adopted in the approved budget.***

1.9.34 There may be differences between the accounting basis (cash, accrual, or some modification thereof) used in preparation and presentation of the budget and the accounting basis used in the financial statements. These differences may occur when the accounting system and the budget system compile information from different perspectives – the budget may focus on cash flows plus certain accruals and commitments, while the financial statements report cash receipts and cash payments.

1.9.35 Formats and classification schemes adopted for presentation of the approved budget may also differ from the formats adopted for the financial statements. An approved budget may classify items on the same basis as is adopted in the financial statements, for example, expenditures by economic nature (compensation of employees, supplies and consumables, grants and transfers, etc) or function (health, education, etc). Alternatively, the budget may classify items by specific programs (for example, poverty reduction or control of contagious diseases) or program components linked to performance outcome objectives (for example, students graduating from tertiary education or surgical operations performed by hospital emergency services), which differ from classifications adopted in the financial statements. Further, a recurrent budget for ongoing operations (for example, education or health) may be approved separately from a capital budget for capital outlays (for example, infrastructure or buildings).

1.9.36 Disclosure of the budgetary basis and classification basis adopted for the preparation and presentation of approved budgets will assist users to better understand the relationship between the budget and accounting information disclosed in the financial statements.

1.9.37 ***An entity shall disclose in notes to the financial statements the period of the approved budget.***

1.9.38 Financial statements are presented at least annually. Entities may approve budgets for an annual period or for multiyear periods. Disclosure of the period covered by the approved budget where that period differs from the reporting period adopted for the financial statements will assist the user of those financial statements to better understand the relationship of the budget data and budget comparison to the financial statements. Disclosure of the period covered by the approved budget where that period is the same as the period covered by the financial statements will also serve a useful confirmation role, particularly in jurisdictions where interim budgets and financial statements and reports are also prepared.

1.9.39 ***An entity shall identify in notes to the financial statements the entities included in the approved budget.***

1.9.40 Paragraph 1.6.5 of this Standard requires controlling entities to prepare and present consolidated financial statements which encompass budget-dependant entities and GBEs controlled by the government. However, as noted in paragraph 1.9.29, approved budgets prepared in accordance with statistical reporting models may not encompass operations of the government that are undertaken on a commercial or market basis. Consistent with the requirements of paragraph 1.9.25, budget and actual amounts will be presented on a comparable basis. Disclosure of the entities encompassed by the budget will enable users to identify the extent to which the entity's activities are subject to an approved budget and how the budget entity differs from the entity reflected in the financial statements.

Reconciliation of Actual Amounts on a Comparable Basis and Actual Amounts in the Financial Statements

1.9.41 ***The actual amounts presented on a comparable basis to the budget in accordance with paragraph 1.9.25 shall, where the financial statements and the budget are not prepared on a comparable basis, be reconciled to total cash receipts and total cash payments, identifying separately any basis, timing and entity differences. The reconciliation shall be disclosed on the face of the statement of comparison of budget and actual amounts or in the notes to the financial statements.***

1.9.42 Differences between the actual amounts identified consistent with the comparable basis and the actual amounts recognized in the financial statements can usefully be classified into the following:

(a) Budgetary basis differences, which occur when the approved budget is prepared on a basis other than the accounting basis. For example, where the budget is prepared on the accrual basis or modified cash basis and the financial statements are prepared on the cash basis;

(b) Timing differences, which occur when the budget period differs from the reporting period reflected in the financial statements; and

(c) Entity differences, which occur when the budget omits programs or entities that are part of the entity for which the financial statements are prepared.

There may also be differences in formats and classification schemes adopted for presentation of financial statements and the budget.

1.9.43 The reconciliation required by paragraph 1.9.41 of this Standard will enable the entity to better discharge its accountability obligations by identifying major sources of difference between the actual amounts on a budget basis and the total cash receipts and total cash payments recognized in the statement of cash receipts and payments. This Standard does not preclude reconciliation of each major total and subtotal, or each class of items, presented in a comparison of budget and actual amounts with the equivalent amounts in the financial statements.

1.9.44 For entities adopting the cash basis of accounting for preparation of both the budget documents and the financial statements, a reconciliation will not be required where the budget is prepared for the same period, encompasses the same entities and adopts the same presentation format as the financial statements. For other entities adopting the same basis of accounting for the budget and the financial statements, there may be a difference in presentation format, reporting entity or reporting period – for example, the approved budget may adopt a different classification or presentation format to the financial statements, may include only non-commercial activities of the entity, or may be a multiyear budget. A reconciliation would be necessary where there are presentation, timing or entity differences between the budget and the financial statements prepared on the same accounting basis.

1.9.45 ***The disclosure of comparative information in respect of the previous period in accordance with the requirements of this Standard is not required.***

1.9.46 This Standard requires a comparison of budget and actual amounts to be included in the financial statements of entities which make publicly available their approved budget(s). It does not require the disclosure of a comparison of actual amounts of the previous period with the budget of that previous period, nor does it require that the related explanations of differences between the actuals and budget of that previous period be disclosed in the financial statements of the current period.

Effective Date of Section 1.9 of Part 1

1.9.47 ***An entity shall apply Section 1.9 of this International Public Sector Accounting Standard for annual financial statements covering periods beginning on or after January 1, 2009. Earlier application is encouraged. If an entity applies Section 1.9 of this Standard for a period beginning before January 1, 2009 it shall disclose that fact.***

1.9.48 When an entity adopts this Standard subsequent to the effective date of Section 1.9 as specified in paragraph 1.9.47, paragraphs 1.9.1 to 1.9.46 of this Standard apply to the entity's annual financial statements covering periods beginning on or after the date of adoption.

1.10 Recipients of External Assistance

Definitions

1.10.1 ***The following terms are used in this Standard with the meaning specified:***

Assigned External Assistance means any external assistance, including external assistance grants, technical assistance, guarantees or other assistance, received by an entity that is assigned by the recipient to another entity.

Bilateral External Assistance Agencies are agencies established under national law, regulation or other authority of a nation for the purpose of, or including the purpose of, providing some or all of that nation's external assistance.

External Assistance means all official resources which the recipient can use or otherwise benefit from in pursuit of its objectives.

Multilateral External Assistance Agencies are all agencies established under international agreement or treaty for the purpose of, or including the purpose of, providing external assistance.

Non-Governmental Organizations (NGOs) are all foreign or national agencies established independent of control by any government for the purpose of providing assistance to government(s), government agencies, other organizations or to individuals.

Official Resources means all loans, grants, technical assistance, guarantees or other assistance provided or committed under a binding agreement by multilateral or bilateral external assistance agencies or by a government, or agencies of a government, other than to a recipient of the same nation as the government or government agency providing, or committing to provide, the assistance.

Re-Lent External Assistance Loans means external assistance loans received by an entity that are lent by the recipient to another entity.

1.10.2 Different organizations may use different terminology for external assistance or classes of external assistance. For example, some organizations may use the term external aid or aid, rather than external assistance. In these cases, the different terminology is unlikely to cause confusion. However, in other cases, the terminology may be substantially different. In these cases, preparers, auditors and users of general purpose financial statements will need to consider the substance of the definitions rather than just the terminology in determining whether the requirements of this Standard apply.

External Assistance

1.10.3 External assistance is defined in paragraph 1.10.1 as all official resources which the recipient can use or otherwise benefit from in pursuit of its objectives. Official resources as defined in paragraph 1.10.1 does not encompass assistance provided by non-governmental organizations (NGOs), even if such assistance is provided under a binding agreement. Assistance received from NGOs, whether in the form of cash donations or third party settlements, will be presented in the financial statements and disclosed in explanatory notes in accordance with the requirements of Sections 1.1 to 1.9 of Part 1 of this Standard. Paragraph 2.1.64 encourages, but does not require, application of the disclosures required by paragraphs 1.10.1 to 1.10.27 to assistance received from NGO's where practicable.

1.10.4 NGOs as defined in paragraph 1.10.1 are foreign or national agencies established independent of control by any government. In some rare cases, it may not be clear whether the donor organization is a bilateral or multilateral external assistance agency or a NGO, and therefore independent of control by any government. Where such a donor organization provides, or commits to provide, assistance under the terms of a binding agreement, the distinction between official resources as defined in this Standard and resources provided by a NGO may become blurred. In these cases, professional judgment will need to be exercised to determine whether the assistance received satisfies the definition of external assistance and, therefore, is subject to the disclosure requirements specified in this section.

Official Resources

1.10.5 Official resources are defined in paragraph 1.10.1 to be resources committed under a binding agreement by multilateral or bilateral external assistance agencies or governments or government agencies, other than to a recipient of the same nation as the provider of the assistance. Governments as referred to in the definition of official resources may include national, state, provincial or local governments in any nation. Therefore, assistance provided by, for example, a national government or state government agency of one nation to a state or local government of another nation is external assistance as defined in this Standard. However, assistance provided by a national or state government to another level of government within the same nation does not satisfy the definition of official resources, and therefore is not external assistance.

External Assistance Agreements

1.10.6 Governments seeking particular forms of external assistance may participate in formal meetings or rounds of meetings with donor organizations. These may include meetings to discuss the government's macroeconomic plans and its development assistance needs, or bilateral discussions at governmental level regarding trade finance, military assistance, balance of payments and other forms of assistance. They may also include separate meetings to consider the country's emergency assistance needs as those needs arise. Initial discussions may result in statements of intent or pledges which are not binding on the government or the external assistance agency. However, subsequently binding agreements may be set in place to make available assistance loans or grants provided restrictions on access to the funds, if any, are met and agreed conditions or covenants are adhered to by the recipient entity.

1.10.7 External assistance agreements may provide for the entity to:

(a) Draw down in cash the full proceeds of the loan or grant or a tranche of the loan or grant;

(b) Seek reimbursement(s) for qualifying payments made by the entity to a third party settling in cash an obligation(s) of the entity, as defined by the loan or grant agreement; or

(c) Request the external assistance agency to make payments directly to a third party settling in cash an obligation(s) of the recipient entity as defined by the loan or grant agreement, including an obligation of the recipient entity for goods or services provided or to be provided by a NGO.

External assistance agreements may also include the provision of goods or services in-kind to the recipient.

External Assistance Received

1.10.8 ***The entity should disclose separately on the face of the Statement of Cash Receipts and Payments, total external assistance received in cash during the period.***

1.10.9 ***The entity should disclose separately, either on the face of the Statement of Cash Receipts and Payments or in the notes to the financial statements, total external assistance paid by third parties during the period to directly settle obligations of the entity or purchase goods and services on behalf of the entity, showing separately:***

(a) ***Total payments made by third parties which are part of the economic entity to which the reporting entity belongs; and***

(b) ***Total payments made by third parties which are not part of the economic entity to which the reporting entity belongs.***

These disclosures should only be made when, during the reporting period, the entity has been formally advised by the third party or the recipient that such payment has been made, or has otherwise verified the payment.

1.10.10 ***Where external assistance is received from more than one provider, the significant classes of providers of assistance should be disclosed separately, either on the face of the Statement of Cash Receipts and Payments or in the notes to the financial statements.***

1.10.11 ***Where external assistance is received in the form of loans and grants, the total amount received during the period as loans and the total amount received as grants should be shown separately, either on the face of the Statement of Cash Receipts and Payments or in the notes to the financial statements.***

1.10.12 External assistance may be provided directly to the reporting entity in the form of cash. Alternatively, a third party may provide external assistance by settling an obligation of the reporting entity or purchasing goods and services for the benefit of the reporting entity. In some cases:

(a) The third party may be part of the economic entity to which the reporting entity belongs – this will occur where, for example, external assistance in the form of cash is provided for the benefit of a program run by a particular department in a jurisdiction where the government manages the expenditure of its individual departments and other entities through a centralized treasury function or a "single account" arrangement. In these cases, the treasury or other central agency receives the external assistance and makes payments of amounts provided by way of external assistance on behalf of the department, after appropriate authorization and documentation from the department; or

(b) The third party may not be part of the economic entity to which the reporting entity belongs - this will occur where, for example, an aid agency makes a debt repayment to a regional development bank on behalf of a government agency, pays a construction company directly for building a road for a particular government agency rather than providing the funds directly to the government agency itself, or funds the operation of a health or education program of an independent provincial or municipal government by directly paying service providers and acquiring on behalf of the government the necessary supplies during the period.

1.10.13 Disclosure of the amount of external assistance received in the form of cash and in the form of third party payments made on behalf of the entity will indicate the extent to which the operations of the reporting entity are funded from taxes and/or internal sources, or are dependent upon external assistance. Consistent with the requirements of paragraph 1.3.24 of this Standard, external assistance paid by third parties should only be disclosed in the statement of Cash Receipts and Payments when the reporting entity has been formally advised that such payments have been made during the reporting period or otherwise verifies their occurrence. Disclosure of the significant classes of external assistance received is also encouraged, but not required (see paragraph 2.1.66).

1.10.14 Disclosure of the significant classes of providers of assistance such as, for example, multilateral donors, bilateral donors, international assistance organizations, national assistance organizations or other major classes as appropriate for the reporting entity will identify the extent of the entity's dependence on particular classes of providers and will be relevant to an assessment of the sustainability of the assistance. This Standard does not require the disclosure of the identity of each provider of assistance or the amount of assistance each provides. However, disclosure of the amount provided by each provider in the currency provided is encouraged (see paragraph 2.1.70).

1.10.15 External assistance is often denominated in a currency other than the reporting currency of the entity. Cash receipts, or payments made by third parties on behalf of the entity arising from transactions in a foreign currency, will be recorded or reported in the entity's reporting currency by applying to the foreign currency amount the exchange rate between the reporting currency and the foreign currency at the date of the receipts or payments in accordance with paragraph 1.7.2 of this Standard.

1.10.16 National governments usually retain the exclusive right to enter into external assistance agreements with multilateral or bilateral external assistance agencies. In many of these cases, the project or activity is implemented by another entity. The national government may re-lend or assign the funds received to the other entity. The terms and conditions of the re-lent or assigned funds may be the same as received from the external assistance agency or may be different than initially received. In some cases, a small fee or interest spread is charged to cover the national government's administrative costs. An entity which enters into an external assistance agreement and passes the benefits as well as the terms and conditions of the agreement through to another entity by way of a subsidiary agreement will recognize or report the external assistance as it is received. It will also record payments to the second entity in accordance with its normal classification of payments adopted in the financial statements.

1.10.17 Where the initial recipient of a loan or grant passes the proceeds and the terms and conditions of the loan or grant through to another entity, the initial entity may simply be administering the loan or grant on behalf of the end user. Netting of transactions where the terms and conditions are substantially the same may be appropriate in the financial statements of the administrator, in accordance with the provisions of paragraph 1.3.13 of this Standard.

Undrawn External Assistance

1.10.18 ***The entity should disclose in the notes to the financial statements the balance of undrawn external assistance loans and grants available at reporting date to fund future operations when, and only when, the amount of the loans or grants available to the recipient is specified in a binding agreement and the satisfaction of any substantial terms and conditions that determine, or affect access to, that amount is highly likely, showing separately in the reporting currency:***

(a) ***Total external assistance loans; and***

(b) ***Total external assistance grants.***

Significant terms and conditions that determine, or affect access to, the amount of the undrawn assistance should also be disclosed.

1.10.19 The amount of external assistance currently committed under a binding agreement(s) but not yet drawn may be significant. In some cases, the amount of the assistance loan(s) or grant(s) is specified in a binding agreement and the satisfaction of any substantial conditions that need to be satisfied to access that amount is highly likely. This may occur in respect of undrawn balances of project funding for projects currently under development where conditions have been, and continue to be, satisfied and the project is anticipated to continue under the terms of the agreement. Where such undrawn balances are provided in a foreign currency, opening and closing balances will be determined by applying to the foreign currency amount the exchange rate on the reporting dates in accordance with the provisions of paragraph 1.7.3 of this Standard.

1.10.20 In some cases, a donor entity may express an intention to provide ongoing assistance to the reporting entity, but not specify in a binding agreement the amount of the assistance loan(s) or grant(s) to be provided in future periods – for example, this may occur where the amount of assistance to be provided is dependent on the annual budget of the donor nation or other sources of funding that may be secured by the recipient. In other cases, the amount of assistance may be specified but be subject to terms and conditions, the satisfaction of which cannot be assessed as being highly likely at the reporting date – for example, this may occur in respect of balance of payment assistance to be provided on achievement of specified performance criteria, or emergency assistance to be provided subject to the amount of assistance provided by other agencies. In these cases, disclosure of the undrawn amounts is not made. In some cases, professional judgment may need to be exercised in assessing whether the satisfaction of the substantial terms and conditions that determine, or effect access to, the external assistance is highly likely.

Receipt of Goods or Services

1.10.21 ***Where an entity elects to disclose the value of external assistance received in the form of goods or services, it should also disclose in the notes to the financial statements the basis on which that value is determined.***

1.10.22 Paragraph 2.1.90 of this Standard encourages an entity to disclose separately in the notes to the financial statements the value of external assistance received in the form of goods or services. Paragraph 1.3.38 of this Standard explains that where encouraged disclosures are included in notes to the financial statements, they will need to be understandable and to satisfy the other qualitative characteristics of financial information. Where an entity elects to make such disclosures, it is required to disclose in the notes to the financial statements the basis on which that value is determined. Such disclosure will enable users to assess whether, for example, the value is determined by reference to donor valuation, fair value determined by reference to prices in the world or domestic markets, by management assessment or on another basis.

Disclosure of Debt Rescheduled or Cancelled

1.10.23 ***An entity should disclose in the notes to the financial statements the amount of external assistance debt rescheduled or cancelled during the period, together with any related terms and conditions.***

1.10.24 An entity experiencing difficulty in servicing its external assistance debt may seek renegotiation of the terms and conditions of the debt or cancellation of the debt. Disclosure of the amount of external assistance debt rescheduled or cancelled, together with any related terms and conditions, will alert users of the financial statements that such renegotiation or cancellation has occurred. This will provide useful input to assessments of financial condition of the entity and changes therein.

Disclosure of Non Compliance with Significant Terms and Conditions

1.10.25 ***An entity should disclose, in notes to the financial statements, significant terms and conditions of external assistance loan or grant agreements or guarantees that have not been complied with during the period when non compliance resulted in cancellation of the assistance or has given rise to an obligation to return assistance previously provided. The amount of external assistance cancelled or to be returned should also be disclosed.***

1.10.26 External assistance agreements will usually include terms and conditions that must be complied with for ongoing access to assistance funds, as well as some procedural terms and conditions.

1.10.27 The disclosures required by paragraph 1.10.25 will enable readers to identify the instances of non compliance that have adversely affected the funds that are available to support the entity's future operations. It will also provide input to assessments of whether re-establishment of compliance with the agreement may occur in the future. Disclosure of non compliance with significant terms and conditions in other cases is also encouraged, but not required (see paragraph 2.1.83).

Effective Date of Section 1.10 and Transitional Provisions

1.10.28 ***Paragraphs 1.10.1 to 1.10.34 of this International Public Sector Accounting Standard become effective for annual financial statements covering periods beginning on or after 1 January 2009.***

1.10.29 ***Entities are not required to disclose comparative figures for amounts disclosed in accordance with paragraphs 1.10.1 to 1.10.27 in the first year of application of paragraphs 1.10.1 to 1.10.34 of this Standard.***

1.10.30 ***Entities are not required to disclose separately in the notes to the financial statements the balance of undrawn external assistance as specified in paragraph 1.10.18 for a period of two years from the date of first application of paragraphs 1.10.1 to 1.10.34 of this Standard.***

1.10.31 ***When an entity applies the transitional provisions in paragraph 1.10.29 and 1.10.30, it should disclose that it has done so.***

1.10.32 In the first year of application of the requirements of paragraphs 1.10.1 to 1.10.27 of this Standard, an entity may not have readily available, or reasonable access to, the information necessary to enable it to satisfy the requirement to disclose comparative information. It may also not have the information necessary to enable it to disclose the closing balance of undrawn external assistance as required by paragraph 1.10.18.

1.10.33 Paragraph 1.4.16 of this Standard provides relief from the requirement to disclose comparative information for the previous period on initial application of the Standard. Some entities may have adopted the Cash Basis IPSAS prior to its amendment to include the requirements relating to disclosure of information by recipients of external assistance as specified in paragraphs 1.10.1 to 1.10.27. Paragraph 1.10.29 provides relief from the requirement to disclose comparative information about external assistance as specified in paragraphs 1.10.1 to 1.10.27 in this Standard in the first year of application of those paragraphs. Paragraph 1.10.30 provides relief from the requirement to apply paragraph 1.10.18 for a period of two years from initial application of that paragraph.

1.10.34 To ensure users are informed of the extent to which the requirements of this Standard have been complied with, paragraph 1.10.31 requires that entities that make use of these transitional provisions disclose that they have done so.

Appendix 1

Illustration of the Requirements of Part 1 of the Standard

This Appendix is illustrative only and does not form part of the Standard. It illustrates an extract of a Statement of Receipts and Payments and relevant note disclosures for a government that has received external assistance loans and grants during the current and preceding periods. Its purpose is to assist in clarifying the meaning of the standards by illustrating their application in the preparation and presentation of general purpose financial statements under the cash basis of accounting for:

(a) ***A Government*** *which is a recipient of external assistance;*

(b) ***A Government Entity*** *which controls its own bank account, and is not a recipient of external assistance; and*

(c) ***A Government Department*** *which operates under a "single account" system such that a central entity administers cash receipts and payments on behalf of the Department, and is not a recipient of external assistance.*

APPENDIX 1A
CONSOLIDATED FINANCIAL STATEMENTS FOR GOVERNMENT A
CONSOLIDATED STATEMENT OF CASH RECEIPTS AND PAYMENTS FOR YEAR ENDED DECEMBER 31, 200X (RECEIPTS ONLY)

(in thousands of currency units)	Note	2000X Receipts/ (Payments) controlled by entity		2000X Payments by third parties		200X-1 Receipts/ (Payments) controlled by entity		200X-1 Payments by third parties	
RECEIPTS									
Taxation									
Income tax		X		-		X		-	
Value-added tax		X		-		X		-	
Property tax		X		-		X		-	
Other taxes		X		-		X		-	
			X		-		X		-
External Assistance	10								
Multilateral Agencies		X		X		X		X	
Bilateral Agencies		X		X		X		X	
			X		X		X		X
Other Grants and Aid			X		X		X		X
Other Borrowings									
Proceeds from borrowing	3		X		X				
Capital Receipts									
Proceeds from disposal of plant and equipment			X		-		X		-
Trading Activities									
Receipts from trading activities			X		-		X		-
Other receipts	4		X		X		X		X
Total receipts			**X**		**X**		**X**		**X**

(in thousands of currency units)	Note	200X Receipts/(Payments) controlled by entity	200X Payments by third parties	200X-1 Receipts/(Payments) controlled by entity	200X-1 Payments by third parties
PAYMENTS					
Operations					
Wages, salaries and employee benefits		(X)	(X)	(X)	(X)
Supplies and consumables		(X)	(X)	(X)	(X)
		(X)	(X)	(X)	(X)
Transfers					
Grants		(X)	-	(X)	-
Other transfer payments		(X)	-	(X)	-
		(X)	-	(X)	-
Capital Expenditures					
Purchase/construction of plant and equipment		(X)	(X)	(X)	(X)
Purchase of financial instruments		(X)	-	(X)	-
		(X)	(X)	(X)	(X)
Loan and Interest Repayments					
Repayment of borrowings		(X)	-	(X)	-
Interest payments		(X)	-	(X)	-
		(X)	-	(X)	-
Other payments	5	(X)	(X)	(X)	(X)
Total payments		**(X)**	**(X)**	**(X)**	**(X)**
Increase/(Decrease) in Cash		**X**	-	**X**	-
Cash at beginning of year	2	**X**	**N/A***	**X**	**N/A**

* N/A = Not applicable.

(in thousands of currency units)	Note	200X Receipts/ (Payments) controlled by entity	200X Payments by third parties	200X-1 Receipts/ (Payments) controlled by entity	200X-1 Payments by third parties
Increase/(Decrease) in Cash		**X**	**N/A**	**X**	**N/A**
Cash at end of year	*2*	**X**	**N/A**	**X**	**N/A**

STATEMENT OF COMPARISON OF BUDGET AND ACTUAL AMOUNT

For Government X for the Year Ended December 31, 200X

Budget Approved on the Cash Basis
(Classification of Payments by Functions)

(in thousands of currency units)	*Actual Amounts	Final Budget	Original Budget	***Difference: Final Budget and Actual*
CASH INFLOWS				
Taxation	X	X	X	X
Aid agreements				
International agencies	X	X	X	X
Other grants and aid	X	X	X	X
Proceeds: borrowing	X	X	X	X
Proceeds: disposal of plant and equipment	X	X	X	X
Trading activities	X	X	X	X
Other receipts	X	X	X	X
Total receipts	**X**	**X**	**X**	**X**
CASH OUTFLOWS				
Health	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)
Public order/safety	(X)	(X)	(X)	(X)
Social protection	(X)	(X)	(X)	(X)
Defense	(X)	(X)	(X)	(X)
Housing and community amenities	(X)	(X)	(X)	(X)
Recreational, cultural and religion	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)
Total payments	**(X)**	**(X)**	**(X)**	**(X)**
NET CASH FLOWS	**X**	**X**	**X**	**X**

* Actual amounts encompass both cash and third party settlements.

** The "Difference…" column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

ADDITIONAL FINANCIAL STATEMENTS (OPTIONAL)

Additional financial statements may be prepared to provide details of amounts included in the consolidated statement of cash receipts and payments: for example, to disclose information by major fund groups or to disclose expenditures by major functions or programs, or to provide details of sources of borrowings. Columns disclosing budgeted amounts may also be included.

STATEMENT OF CASH RECEIPTS BY FUND CLASSIFICATION

(in thousands of currency units)	**200X** Receipts controlled by entity	**200X-1** Receipts controlled by entity
RECEIPTS		
Consolidated Funds	X	X
Special Funds	X	X
Trading Funds	X	X
Loans	X	X
Total receipts	**X**	**X**

PROCEEDS OF BORROWINGS

	Note	**200X**		**200X-1**	
(in thousands of currency units)		**Cash Receipts controlled by entity**	**Resulting from Payments by third parties**	**Receipts controlled by entity**	**Resulting from Payments by third parties**
BORROWINGS					
Domestic Commercial Institution		X	-	X	-
Offshore Commercial Institution		X	-	X	-
Development Banks and Similar Lending Agencies		X	X	X	X
Total borrowings	3	**X**	**X**	**X**	**X**

STATEMENT OF PAYMENTS BY PROGRAMS/ACTIVITIES/FUNCTION OF GOVERNMENT

(in thousands of currency units)	200X Payments controlled by entity	200X Payments by third parties	200X-1 Payments controlled by entity	200X-1 Payments by third parties
PAYMENTS/EXPENDITURE – Operating Account				
Education Services	X	X	X	X
Health Services	X	X	X	X
Social Security and Welfare	X	-	X	-
Defense	X	-	X	-
Public Order and Safety	X	X	X	X
Recreation, Culture and Religion	X	X	X	X
Economic Services	X	-	X	-
Other	X	X	X	X
Total payments/expenditure	**X**	**X**	**X**	**X**
PAYMENTS/EXPENDITURE – Capital Account				
Education Services	X	X	X	X
Health Services	X	X	X	X
Social Security and Welfare	X	-	X	-
Defense	X	-	X	-
Public Order and Safety	X	X	X	X
Recreation, Culture and Religion	X	X	X	X
Other	X	X	X	X
Total payments/expenditure	**X**	**X**	**X**	**X**
Total Operating and Capital Accounts	**X**	**X**	**X**	**X**

PUBLIC SECTOR ENTITY—WHOLE-OF-GOVERNMENT

Notes to the Financial Statements

1. <u>Accounting Policies</u>

Basis of preparation

The financial statements have been prepared in accordance with Cash Basis IPSAS *Financial Reporting Under The Cash Basis of Accounting*.

The accounting policies have been applied consistently throughout the period.

Reporting entity

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

(i) Central government ministries; and

(ii) Government business enterprises and trading funds that are under the control of the entity.

The consolidated financial statements include all entities controlled during the year. A list of significant controlled entities is shown in Note 7 to the financial statements.

Payments by Third Parties

The government also benefits from goods and services purchased on its behalf as a result of cash payments made by third parties during the period by way of loans and contributions. The payments made by the third parties do not constitute cash receipts or payments by the government but do benefit the government. They are disclosed in the *Payments by third parties* column in the Consolidated Statement of Cash Receipts and Payments and other financial statements.

Reporting currency

The reporting currency is (currency of Country A).

2. <u>Cash</u>

Cash comprises cash on hand, demand deposits and cash equivalents. Demand deposits and cash equivalents consist of balances with banks and investments in short-term money market instruments.

Cash included in the statement of cash receipts and payments comprise the following amounts:

(in thousands of currency units)	**200X**	**200X-1**
Cash on hand and balances with banks	X	X
Short-term investments	X	X
	X	X

Included in the amount stated above is X currency units provided by the International Agency XX that is restricted to the construction of road infrastructure.

3. Borrowings

Borrowings comprise cash inflows from banks, similar lending agencies and commercial institutions and amounts owing in respect of non-cash assistance provided by third parties.

4. Other Receipts

Included in other receipts are fees, fines, penalties and miscellaneous receipts.

5. Other Payments/Expenditure

Included in other payments are dividends, distributions paid, legal settlements of lawsuits and miscellaneous payments.

6. Undrawn Borrowing Facilities Other than Undrawn External Assistance

(See note 10 for undrawn external assistance)

(in thousands of currency units)	**200X**	**200X-1**
Movement in Undrawn Borrowing Facilities		
Undrawn borrowing facilities at 1.1.0X	X	X
Additional loan facility	X	X
Total available	X	X
Amount drawn	(X)	(X)
Facility closure/cancellations	(X)	(X)
Undrawn borrowing facilities at 31.12.0X.	X	X

(in thousands of currency units)	**200X**	**200X-1**
Undrawn Borrowing Facilities		
Commercial Financial Institutions	X	X
Total undrawn borrowing facilities	X	X

7. Significant Controlled Entities

Entity	Jurisdiction
Entity A	X
Entity B	X
Entity C	X
Entity D	X

8. Authorization Date

The financial statement was authorized for publication on XX *Month* 200X+1 by Mr YY, the Treasurer of Country A.

9. Original and Final Approved Budget and Comparison of Actual and Budget Amounts

The approved budget is developed on the same accounting basis (cash basis), same classification basis, and for the same period (from 1 January 200X to 31 December 200X) as for the financial statements. It encompasses the same entities as the consolidated financial statement – these are identified in Note 7 above.

The original budget was approved by legislative action on (date) and a supplemental appropriation of XXX for disaster relief support was approved by legislative action on (date) due to the earthquake in the Northern Region on (date). The original budget objectives and policies, and subsequent revisions are explained more fully in the Operational Review and Budget Out-turn Report issued in conjunction with the financial statements.

The excess of actual expenditure over the final budget of 15% (25% over original budget) for the Health function was due to expenditures above the level approved by legislative action in response to the earthquake. There were no other material differences.

Alternative Note 9 when budget and financial statements are prepared on a different basis

9. Original and Final Approved Budget and Comparison of Actual and Budget Amounts

The budget is approved on a modified cash basis by functional classification. The approved budget covers the fiscal period from January 1, 200X to December 31, 200X and includes all entities within the general government sector. The general government sector includes all government departments – these are identified in Note 7 above.

The original budget was approved by legislative action on (date) and a supplemental appropriation of XXX for disaster relief support was approved by legislative action on (date) due to the earthquake in the Northern Region on (date). The original budget objectives and policies, and subsequent revisions are explained more fully in the

Operational Review and Budget Out-turn Report issued in conjunction with the financial statements.

The excess of actual expenditure over the final budget of 15% (25% over original budget) for the Health function was due to expenditures above the level approved by legislative action in response to the earthquake. There were no other material differences between the final approved budget and the actual amounts.

The budget and the accounting bases differ. The financial statements for the whole-of-government are prepared on the cash basis using a classification based on the nature of expenses in the statement of financial performance. The financial statements are consolidated statements which include all controlled entities, including government business enterprises for the fiscal period from January 1, 20XX to December 31 20XX. The budget is approved on the modified cash basis by functional classification and deals only with the general government sector which excludes government business enterprises and certain other non-market government entities and activities.

The amounts in the statement of cash receipts and payments were adjusted to be consistent with the modified cash basis and reclassified by functional classification to be on the same basis as the final approved budget. In addition, adjustments to amounts in the statement of cash receipts and payments for timing differences associated with the continuing appropriation and differences in the entities covered (government business enterprises and other entities) were made to express the actual amounts on a comparable basis to the final approved budget.

A reconciliation between the actual inflows and outflows as presented in the statement of comparison of budget and actual amounts and the amounts of total cash receipts and total cash payments reported in the statement of cash receipts and payments for the year ended December 31, 20XX is presented below.

	Total inflows	**Total outflows**
Actual Amount on Comparable Basis as Presented in the Budget and Actual Comparative Statement	**X**	**X**
Basis Differences	X	X
Timing Differences	-	-
Entity Differences	X	X
Total Cash receipts	**X**	
Total Cash Payments		**X**

The financial statements and budget documents are prepared for the same period. There is an entity difference: the budget is prepared for the general government sector and the financial statements consolidate all entities controlled by the government. There is also a basis difference: the budget is prepared on a cash basis and the financial statements on the modified cash basis.

This reconciliation could be included on the face of the Statement of Comparison of Budget and Actual Amounts or as a note disclosure.

10. External Assistance

Payments by Third Parties

All payments made by third parties are made by third parties which are not part of the economic entity.

External Assistance

External assistance was received in the form of loans and grants from multilateral and bilateral donor agencies under agreements specifying the purposes for which the assistance will be utilized. The following amounts are presented in the reporting currency of the entity.

	200X Total	200X-1 Total
Loan Funds		
Multilateral Agencies	X	X
Bilateral Agencies	X	X
Total	X	X
Grant Funds		
Multilateral Agencies	X	X
Bilateral Agencies	X	X
Total	X	X
Total External Assistance	**X**	**X**

Non Compliance with significant terms and conditions and rescheduled and cancelled debt

There have been no instances of non compliance with terms and conditions which have resulted in cancellation of external assistance loans.

External assistance grants of X domestic currency units were cancelled during the reporting period. The cancellation resulted from over estimation of the cost of specified development projects and consequentially expenditure of an amount less than that committed for the period by the donor entity.

Undrawn External Assistance

Undrawn external assistance loans and grants at reporting date are amounts specified in a binding agreement which relate to funding for projects currently under development, where conditions have been satisfied, and their ongoing satisfaction is highly likely, and the project is anticipated to continue to completion.

	Loans 200X	**Grants 200X**	**Loans 200X-1**	**Grants 200X-1**
Closing balance in reporting currency	X	X	X	X

The significant terms and conditions that determine or affect access to the amount of undrawn assistance relate to the achievement of the following specified construction targets for development of medical and education infrastructure: (Entity to identify significant construction targets).

APPENDIX 1B
GOVERNMENT ENTITY AB
(THIS ENTITY CONTROLS ITS OWN BANK ACCOUNT AND ALSO BENEFITS FROM PAYMENTS MADE BY THIRD PARTIES.)
CONSOLIDATED STATEMENT OF CASH RECEIPTS AND PAYMENTS
FOR YEAR ENDED DECEMBER 31, 200X

	Note	200X			200X-1		
(in thousands of currency units)		**Receipts/ (Payments) controlled by entity**	**Payments by other government entities**	**Payments by external third parties**	**Receipts/ (Payments) controlled by entity**	**Payments by other government entities**	**Payments by external third parties**
RECEIPTS							
Authorized allocations/Appropriations		X	X	-	X	X	-
Other receipts		X	-	-	X	-	-
Grants/Assistance		-	-	X	-	-	X
Total receipts		**X**	**X**	**X**	**X**	**X**	**X**
PAYMENTS							
Wages, salaries and employee benefits		(X)	-	-	(X)	-	-
Rent		(X)	(X)	-	(X)	(X)	-
Capital Expenditure		(X)	(X)	(X)	(X)	(X)	(X)
Transfers	3	(X)	(X)	(X)	(X)	(X)	(X)

(in thousands of currency units)	Note	200X Receipts/ (Payments) controlled by entity	200X Payments by other government entities	200X Payments by external third parties	200X-1 Receipts/ (Payments) controlled by entity	200X-1 Payments by other government entities	200X-1 Payments by external third parties
Total payments		**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**
Increase/(Decrease) in Cash		**X**	**X**	**(X)**	**X**	**(X)**	**X**
Cash at beginning of year	2	**X**	**N/A***	**N/A**	**X**	**N/A**	**N/A**
Increase/(Decrease) in Cash		**X**	**N/A**	**N/A**	**X**	**N/A**	**N/A**
Cash at end of year	*2*	**X**	**N/A**	**N/A**	**X**	**N/A**	**N/A**

* N/A = Not Applicable.

ADDITIONAL FINANCIAL STATEMENTS (OPTIONAL)

Additional financial statements may be prepared, for example, to disclose budget information by major fund groups if applicable or to display expenditures by major functions. An example of a statement by function is included below.

STATEMENT OF PAYMENTS BY FUNCTION

	Note	200X			200X-1		
(in thousands of currency units)		Payments controlled by entity	Payments by other government entities	Payments by external third parties	Payments controlled by entity	Payments by other government entities	Payments by external third parties
PAYMENTS/EXPENDITURE							
Program I		(X)	(X)	(X)	(X)	(X)	(X)
Program II		(X)	(X)	(X)	(X)	(X)	(X)
Program III		(X)	(X)	(X)	(X)	(X)	(X)
Program IV		(X)	(X)	(X)	(X)	(X)	(X)
Other payments/expenditure		(X)	(X)	(X)	(X)	(X)	(X)
Total payments/expenditure		**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**

GOVERNMENT ENTITY AB

Notes to the Financial Statements

1. Accounting Policies

Basis of preparation

The financial statements have been prepared in accordance with Cash Basis IPSAS "Financial Reporting Under the Cash Basis of Accounting."

The accounting policies have been applied consistently throughout the period.

Reporting entity

The financial statements are for a public sector entity (Government Entity AB). The financial statements encompass the reporting entity as specified in the relevant legislation (Public Finance Act 20XX). This comprises Government Entity AB and its controlled entities. Government Entity AB is controlled by the national government of Country A.

Government Entity AB's principal activity is to provide [identify type of] services to constituents. The Entity controls its own bank account. Appropriations and other cash receipts are deposited into its bank accounts.

Payments by other government entities

The Entity benefits from payments made by its controlling entity (Government A) and other government entities on its behalf.

Payments by external third parties

The Entity also benefits from payments made by external third parties (entities external to the economic entity) for goods and services. These payments do not constitute cash receipts or payments of the Entity, but do benefit the Entity. They are disclosed in the *Payments by external third parties* column in the Statement of Cash Receipts and Payments and in other financial statements.

Reporting currency

The reporting currency is (currency of Country A).

2. Cash

Cash comprises cash on hand, demand deposits and cash equivalents. Demand deposits and cash equivalents comprise balances with banks and investments in short-term money market instruments.

Amounts appropriated to the Entity are deposited in the Entity's bank account and are controlled by the entity. All borrowings are undertaken by a central finance entity.
Receipts from exchange transactions are deposited in trading fund accounts controlled by the Entity. They are transferred to consolidated revenue at year end.

Cash included in the statement of cash receipts and payments comprise the following amounts:

(in thousands of currency units)	**200X**	**200X-1**
Cash on hand and balances with banks	X	X
Short-term investments	X	X
	X	X

3. Transfers

Amounts are transferred to eligible recipients in accordance with operating mandate and authority of the entity.

4. Significant Controlled Entities

Entity	**Jurisdiction**
Entity A	X
Entity B	X

5. Authorization Date

The financial statements were authorized for issue on XX *Month* 200X+1 by Mr YY, Minister of XXXXX for Entity AB.

APPENDIX 1C
GOVERNMENT DEPARTMENT AC
(THE GOVERNMENT OPERATES A CENTRALIZED SINGLE ACCOUNT SYSTEM– THE ENTITY DOES NOT CONTROL AMOUNTS APPROPRIATED FOR ITS USE.)
STATEMENT OF CASH RECEIPTS AND PAYMENTS
FOR YEAR ENDED 31 DECEMBER 200X

	Note	200X		200X-1	
(in thousands of currency units)		**Treasury Account/ Single Control Account**	**Payments by external third parties**	**Treasury Account/ Single Control Account**	**Payments by external third parties**
RECEIPTS					
Allocations/ Appropriations	2	X	-	X	-
Other receipts		X	-	X	-
Assistance		-	X	-	X
Total receipts		**X**	**X**	**X**	**X**
PAYMENTS					
Wages, salaries and employee benefits		(X)	-	(X)	-
Rent		(X)	-	(X)	-
Capital Expenditure		(X)	(X)	(X)	(X)
Transfers	3	(X)	(X)	(X)	(X)
Total payments		**(X)**	**(X)**	**(X)**	**(X)**

ADDITIONAL FINANCIAL STATEMENTS (OPTIONAL)

Additional financial statements may be prepared, for example, to disclose budget information by major fund groups if applicable or to display expenditures by major functions or payments. An example of a statement by function is included below.

STATEMENT OF PAYMENTS BY FUNCTION

	Note	200X		200X-1	
(in thousands of currency units)		**Treasury Account/ Single Control Account**	**Payments by external third parties**	**Treasury Account/ Single Control Account**	**Payments by external third parties**
PAYMENTS					
Program I		X	X	X	X
Program II		X	X	X	X
Program III		X	X	X	X
Program IV		X	X	X	X
Other payments		X	X	X	X
Total payments		**X**	**X**	**X**	**X**

GOVERNMENT DEPARTMENT AC

Notes to the Financial Statements

1. Accounting Policies

Basis of preparation

The financial statements have been prepared in accordance with Cash Basis IPSAS "Financial Reporting Under The Cash Basis of Accounting."

The accounting policies have been applied consistently throughout the period.

Reporting entity

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

Government Department AC's principal activity is to provide services to constituents.

Government Department AC does not operate its own bank account. The Government operates a centralized treasury function which administers cash expenditures incurred by all departments during the financial year. Payments made on this account in respect of the Department are disclosed in the Treasury Account column in the Statement of Cash Receipts and Payments and other financial statements.

Payments by external third parties

Government Department AC benefits from goods and services purchased on its behalf as a result of cash payments made by third parties external to the Government during the reporting period. The payments made by the third parties do not constitute cash receipts or payments of the Department but do benefit the Department. They are disclosed in the *Payments by external third parties* column in the Statement of Cash Receipts and Payments and other financial statements.

Reporting currency

The reporting currency is (currency of Country A).

2. Appropriations

Amounts appropriated to Government Department AC are managed through a central account administered by the Office of the Treasury. These amounts are not controlled by Department AC but are deployed on the Department's behalf by the central account administrator on presentation of appropriate documentation and authorization. All borrowings are undertaken by a central finance entity. The amount reported as allocations/appropriations in the statement of cash receipts and payments is the amount the Office of the Treasury has expended for the benefit of Department AC (the amount “drawn down”).

3. Transfers

Amounts are transferred to eligible recipients in accordance with the operating mandate and authority of Department AC.

4. Authorization Date

The financial statements were authorized on XX *Month* 200X+1 by Mr YY, Minister of XXXXX for Government Department AC.

PART 2: FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING—ENCOURAGED ADDITIONAL DISCLOSURES

This part of the Standard is not mandatory. It sets out encouraged additional disclosures for reporting under the cash basis. It should be read together with Part 1 of this Standard, which sets out the requirements for reporting under the cash basis of accounting. The encouraged disclosures, which have been set in italic, should be read in the context of the commentary paragraphs in this part of the Standard, which are in plain type.

FINANCIAL REPORTING UNDER THE CASH BASIS OF ACCOUNTING PART 2: ENCOURAGED ADDITIONAL DISCLOSURES

2.1 Encouraged Additional Disclosures

Definitions

2.1.1 *The following terms are used in this part of the Standard with the meanings specified:*

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

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

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

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

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

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

Extraordinary items are (for the purposes of this Standard) cash flows that arise from events or transactions that are clearly distinct from the ordinary activities of the entity, are not expected to recur frequently or regularly and are outside the control or influence of the entity.

A financial asset is any asset that is:

(a) *Cash;*

(b) *A contractual right to receive cash or another financial asset from another entity;*

(c) *A contractual right to exchange financial instruments with another entity under conditions that are potentially favorable; or* *(d) An equity instrument of another entity.*

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

Ordinary activities are any activities which are undertaken by an entity as part of its service delivery or trading activities. Ordinary activities include such related activities in which the entity engages in furtherance of, incidental to, or arising from these activities.

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

Terms defined in Part 1 of this Standard are used in this part of the Standard with their defined meaning.

Future Economic Benefits or Service Potential

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

Going Concern

2.1.3 *When preparing the financial statements of an entity, those responsible for the preparation of the financial statements are encouraged to make an assessment of the entity's ability to continue as a going concern. When those responsible for the preparation of the financial statements are aware, in making their assessment, of material uncertainties related to events or conditions which may cast significant doubt upon the entity's ability to continue as a going concern, the disclosure of those uncertainties is encouraged.*

2.1.4 The determination of whether an entity is a going concern is primarily relevant for individual entities rather than for the government as a whole. For individual entities, in assessing whether the entity is a going concern, those responsible for the preparation of the financial statements:

(a) Will need to take into account all available information for the foreseeable future which will include, but will not necessarily be limited to, twelve months from the approval of the financial statements; and

(b) May need to consider a wide range of factors surrounding current and expected performance, potential and announced restructurings of organizational units, estimates of receipts or the likelihood of continued government funding, and potential sources of replacement financing before it is appropriate to conclude that the entity is a going concern.

2.1.5 There may be circumstances where the usual going concern tests of liquidity and solvency as applied to business enterprises appear unfavorable, but other factors suggest that the entity is nonetheless a going concern. For example:

(a) In assessing whether the government is a going concern, the power to levy rates or taxes may enable some entities to be considered as a going concern even though their cash payments may exceed their cash receipts for extended periods; and

(b) For an individual entity, an assessment of its cash flows for a reporting period may suggest that the entity is not a going concern. However, there may be multi-year funding agreements in place with the government that will ensure the continued operation of the entity.

Extraordinary Items

2.1.6 *An entity is encouraged to separately disclose the nature and amount of each extraordinary item. The disclosure may be made on the face of the statement of cash receipts and payments, or in other financial statements or in the notes to the financial statements.*

2.1.7 Extraordinary items are characterized by the fact that they arise from events or transactions that are distinct from an entity's ordinary activities, are not expected to recur frequently or regularly and are outside the control or influence of the entity. Accordingly, extraordinary items are rare, unusual and material.

Distinct from Ordinary Activities

2.1.8 Whether an event or transaction is clearly distinct from the ordinary activities of the entity is determined by the nature of the event or transaction in relation to the activities ordinarily carried on by the entity rather than by the frequency with which such events are expected to occur. An event or transaction may be extraordinary for one entity or level of government, but not extraordinary for another entity or level of government, because of the differences between their respective ordinary activities. In the context of whole-of-government reporting, extraordinary items will be extremely rare.

Not Expected to Recur in the Foreseeable Future

2.1.9 The event or transaction will be of a type that would not reasonably be expected to recur in the foreseeable future, taking into account the environment in which the entity operates. The nature of extraordinary items is such that they would not normally be anticipated at the beginning of a reporting period and therefore would not be included in a budget. Inclusion of an item in a budget suggests that the occurrence of the specific item is foreseen and therefore not extraordinary.

Outside the Control or Influence of the Entity

2.1.10 The event or transaction will be outside the control or influence of the entity. A transaction or event is presumed to be outside the control or influence of an entity if the decisions or determinations of the entity do not normally influence the occurrence of that transaction or event.

Identifying Extraordinary Items

2.1.11 Whether or not an item is extraordinary will be considered in the context of the entity's operating environment and the level of government within which it operates. Judgment will be exercised in each case.

2.1.12 Examples of cash flows associated with events or transactions that may, although not necessarily, give rise to extraordinary items for some public sector entities or levels of government are:

(a) Short-term cash flows associated with the provision of services to refugees where the need for such services was unforeseen at the beginning of the period, outside the ordinary scope of activities for the entity and outside the control of the entity. If such services were predictable or occurring in more than one reporting period they would not generally be classified as extraordinary; and

(b) The cash flows associated with the provision of services following a natural or man-made disaster, for example, the provision of shelter to homeless people following an earthquake. In order for a particular earthquake to qualify as an extraordinary event it would need to be of a magnitude that would not normally be expected in either the geographic area in which it occurred or the geographic area associated with the entity, and the provision of emergency services or the restoration of essential services would need to be outside the scope of ordinary activities of the entity concerned. Where an entity has responsibility for providing assistance to those affected by natural disasters, the costs associated with this activity would not generally meet the definition of an extraordinary item.

2.1.13 The restructuring of activities is an example of an event which would normally not be extraordinary for either an individual public sector entity or the whole-of-government entity which incorporates that government body. All three criteria within the definition of an extraordinary item must be satisfied before an item can be classified as extraordinary. A restructuring may clearly be distinct from the ordinary activities of the entity. However, at the whole-of-government level, restructuring may occur frequently. More importantly, restructuring is usually within the control or influence of a whole-of-government entity. It is only in circumstances where the restructuring is imposed by another level of government or by an external regulator or other external authority that it could be classified as outside the control or influence of the whole-of-government entity.

2.1.14 The disclosure of the nature and amount of each extraordinary item may be made on the face of the statement of cash receipts and payments or other financial statements that might be prepared or in the notes to those financial statements. An entity may also decide to disclose only the total amount of extraordinary items on the face of the statement of cash receipts and payments and the details in the notes.

Administered Transactions

2.1.15 *An entity is encouraged to disclose in the notes to the financial statements, the amount and nature of cash flows and cash balances resulting from transactions administered by the entity as an agent on behalf of others where those amounts are outside the control of the entity.*

2.1.16 The cash flows associated with transactions administered by an entity acting as an agent on behalf of others may not pass through a bank account controlled by the reporting entity. In these cases, the entity cannot use, or otherwise benefit from, the cash it administers in the pursuit of its own objectives. These cash flows are not controlled by the entity and therefore are not included in the totals shown on the face of the statement of cash receipts and payments or other financial statements that might be prepared. However, disclosure of the amount and nature of these transactions by major type is encouraged because it provides useful information on the scope of the entity's activities and it is relevant for an assessment of an entity's performance.

2.1.17 Where such cash receipts and payments pass through a bank account controlled by the entity, they are treated as cash flows and balances of the entity itself and included in the totals shown on the face of the statement of cash receipts and payments. Paragraph 1.3.13(a) of Part 1 of this Standard permits such cash receipts and payments to be reported on a net basis. Paragraphs 2.1.18 to 2.1.22 below provide guidance on the cash receipts, payments and balances that:

(a) May be controlled by a government or government entity and will be reported in the statement of cash receipts and payments in accordance with Part 1 of this Standard; and

(b) Are administered transactions which will not be included on the face of the statement of cash receipts and payments or other financial statements that might be prepared but for which disclosure is encouraged.

Revenue Collection

2.1.18 Public sector entities may control cash or administer cash receipts or payments on behalf of the government or other governments or government entities. For example, a government Department of Taxation (or revenue collection agency) may be established with its own bank account and provided with an appropriation to fund its operations. The operations of the Department will include administering certain aspects of the Taxation Act and may encompass the collection of taxes on behalf of the government.

2.1.19 A Department of Taxation can use cash appropriated to it and deposited in a bank account which it controls to achieve its operating objectives as mandated, and can exclude others from using or benefiting from that cash. In these cases, the Department will control the cash appropriated for its own use. However, the cash the Department collects on behalf of the government through its tax collection activities is usually deposited in a specified government trust fund or transferred to a government bank account administered by the Treasury or similar department. In these circumstances, the cash collected cannot be used to support achievement of the objectives of the Department of Taxation, or otherwise deployed at the discretion of the Department's management without specific appropriation or other authorization by the government or relevant body. Therefore, the cash collected is not controlled by the Department of Taxation and would not form part of the cash receipts or cash balances of the Department. As a consequence of a government decision, some of the amounts collected may be appropriated or otherwise allocated for use by the Department. However, it is the government's decision to authorize the expenditure of the funds by the Department of Taxation, rather than the collection of the cash, that gives rise to the control.

2.1.20 Similar circumstances may arise when one government, for example a state or local government, collects cash on behalf of another government (such as a national government). In these cases, the government is acting as an agent for others in the collection of cash. The cash that arises as a result of managing transactions as an agent for others would not usually be deposited in a bank account of the collection agency and therefore would not form part of the cash receipts, cash payments or cash balances of the reporting entity.

“Pass-through” Cash Flows

2.1.21 In some cases, the administrative arrangements in place in respect of the revenue collection activities a government or government entity undertakes as an agent of another party may provide for the cash collected to be initially deposited in the entity’s own bank account before it is transferred to the ultimate recipient. Cash flows arising as a consequence of these transactions are sometimes termed “pass-through” cash flows. In these cases, the entity will:

(a) Control the cash it collects in its capacity as an agent for the, usually short, period the cash is deposited in the entity’s bank account prior to transfer to third parties;

(b) Usually benefit from any interest arising from amounts deposited in interest bearing accounts prior to its transfer to the other entity; and

(c) Have an obligation to transfer the cash collected to third parties in accordance with legislative requirements or administrative arrangements.

When cash inflows from administered transactions pass through a bank account controlled by the reporting entity, the cash receipts, cash transfers and cash balances arising from the collection activity will be included in the entity’s statement of cash receipts and payments in accordance with paragraph 1.3.4(a)(i) of Part 1 of this Standard. Paragraph 1.3.13(a) of Part 1 of this Standard specifies that cash receipts and payments which arise from transactions the entity administers on behalf of other parties and which are recognized in the financial statements may be reported on a net basis.

Transfer Payments

2.1.22 Consistent with a government’s objectives and with legislation or other authority, amounts appropriated to a government entity (a department, agency or similar) may include amounts to be transferred to third parties in respect of, for example, unemployment benefits, age or invalid pensions, family allowances and other social security and community benefit payments. In some cases, these amounts will pass through a bank account controlled by the entity. Where this occurs, the entity will recognize the cash appropriated for transfer during the reporting period as a cash receipt, the amounts transferred during that reporting period as a cash payment and any amounts held at the end of the reporting period for transfer in the future as part of closing balance of cash.

Disclosure of Major Classes of Cash Flows

2.1.23 *An entity is encouraged to disclose, either on the face of the statement of cash receipts and payments or other financial statements or in the notes to those statements:*

(a) *An analysis of total cash payments and payments by third parties using a classification based on either the nature of the payments or their function within the entity, as appropriate; and*

(b) *Proceeds from borrowings. In addition, the amount of borrowings may be further classified into type and source.*

2.1.24 The sub-classifications encouraged in paragraph 2.1.23(a) may be presented on the face of the statement of cash receipts and payments in accordance with the requirements of paragraphs 1.3.12 and 1.3.24 of Part 1 of this Standard. Where a different classification basis is adopted in the statement of cash receipts and payments, additional disaggregated disclosures reflecting the encouragement in paragraph 2.1.23(a) above is encouraged either as a separate statement or by way of note.

2.1.25 Cash payment items and payments by third parties may be further sub-classified in order to enhance accountability by identifying the major purposes for which the payments are made. They may also be sub-classified in order to highlight the costs and cost recoveries of particular programs, activities or other relevant segments of the reporting entity. An entity is encouraged to present this information in at least one of the following two ways.

2.1.26 The first method is referred to as the nature of payments method. Payments are aggregated in the statement of cash receipts and payments according to their nature (for example, purchases of materials, transport costs, wages and salaries), and are not reallocated amongst various functions within the entity. An example of a classification using the nature of payments method is as follows:

	Cash payments	Payments by third parties
Wages and salaries	(X)	(X)
Transport costs	(X)	(X)
Capital acquisitions	(X)	(X)
Borrowing costs	(X)	(X)
Other	(X)	(X)
Total payments	(X)	(X)

2.1.27 The second method, referred to as the functional method of classification, classifies payments according to the program or purpose for which they were made. This presentation often provides more relevant information to users, although the allocation of payments to functions can be arbitrary and may involve considerable judgment. An example of a functional classification of cash payments is as follows:

	Cash payments	Payments by third parties
Health services	(X)	(X)
Education services	(X)	(X)
Capital acquisitions	(X)	(X)
Borrowing costs	(X)	(X)
Other	(X)	(X)
Total payments	(X)	(X)

2.1.28 Under this method, the cash payments associated with the main functions undertaken by the entity are shown separately. In this example, the entity has functions related to the provision of health services and education services. The entity would present cash payment line items for each of these functions.

2.1.29 Entities classifying cash payments by function are encouraged to disclose additional information on the nature of payments, including payments made for salaries and other employee benefits.

2.1.30 Paragraph 1.3.12 of Part 1 of this Standard requires the disclosure of total cash receipts of the entity showing separately a sub-classification of total cash receipts using a classification basis appropriate to the entity's operations. The sub-classification of cash receipts into appropriate classes will depend upon the size, nature and function of the amounts involved. In addition to disclosure of the amount of receipts from external assistance and borrowings, the following sub-classifications may be appropriate:

(a) Receipts from taxation (these may be further sub-classified into types of taxes);

(b) Receipts from fees, fines, penalties and licenses;

(c) Receipts from exchange transactions including receipts from the sale of goods and services and user charges (where these are classified as exchange transactions);

(d) The purposes for which external assistance grants and loans are provided, the providers of that assistance and the amount provided;

(e) Receipts from other grants, transfers, or budget appropriations (possibly classified by source and purpose);

(f) Receipts from interest and dividends; and

(g) Receipts from gifts and donations.

Related Party Disclosures

2.1.31 *An entity is encouraged to disclose in the notes to the financial statements information required by International Public Sector Accounting Standard IPSAS 20, "Related Party Disclosures."*

2.1.32 IPSAS 20, in the accrual based series of IPSASs, defines related parties and other relevant terms, requires the disclosure of related party relationships where control exists and requires the disclosure of certain information about related party transactions, including information about aggregate remuneration of key management personnel.

Disclosure of Assets, Liabilities and Comparison with Budgets

2.1.33 *An entity is encouraged to disclose in the notes to the financial statements:*

(a) *Information about the assets and liabilities of the entity; and*

(b) *If the entity does not make publicly available its approved budget, a comparison with budgets*

2.1.34 Governments and government entities control significant resources in addition to cash and deploy those resources in the achievement of service delivery objectives. They also borrow to fund their activities, incur other debts and liabilities in the course of their operations and make commitments to expend money in the future on the acquisition of capital assets. Non-cash assets and liabilities will not be reported on the face of the statement of cash receipts and payments or other financial statements that might be prepared under the cash basis of accounting. However, governments maintain records of, and monitor and manage, their debt and other liabilities and their non-cash assets. The disclosure of information about assets and liabilities and the costs of particular programs and activities will enhance accountability and is encouraged by this Standard.

2.1.35 Entities that make such disclosures are encouraged to identify assets and liabilities by type, for example, by classifying:

(a) Assets as receivables, investments or property plant and equipment; and

(b) Liabilities as payables, borrowings by type or source and other liabilities.

While such disclosures may not be comprehensive in the first instance, entities are encouraged to progressively develop and build on them. In order to comply with the requirements of paragraphs 1.3.5 and 1.3.37 of Part 1 of this Standard, these disclosures will need to comply with qualitative characteristics of financial information and should be clearly described and readily understood. Accrual basis IPSASs including IPSAS 13, "Leases," IPSAS 17, "Property, Plant and Equipment" and IPSAS 19, "Provisions, Contingent Liabilities and Contingent Assets" can provide useful guidance to entities disclosing additional information about assets and liabilities.

Comparison with Budgets

2.1.36 Public sector entities are typically subject to budgetary limits in the form of appropriations or other budgetary authority which may be given effect through authorizing legislation. One of the objectives of financial reporting by public sector entities is to report on whether cash was obtained and used in accordance with the legally adopted budget. In some jurisdictions, this requirement is reflected in legislation. Entities which make publicly available their approved budgets are required to comply with the requirements of paragraphs 1.9.1 to 1.9.48 of Part 1 of this Standard. This Standard encourages other entities (that is, entities which do not make publicly available their approved budgets) to include in their financial statements the disclosure of a comparison of actual with the budgeted amounts for the reporting period where the financial statements and the budget are on the same basis of accounting. Reporting against budgets for these other entities may be presented in different ways, including:

(a) The preparation of a note with separate columns for budgeted amounts and actual amounts. A column showing any variances from the budget or appropriation may also be presented for completeness; and

(b) Disclosure that the budgeted amounts have not been exceeded. If any budgeted amounts or appropriations have been exceeded, or payments made without appropriation or other form of authority, then details may be disclosed by way of note to the relevant item in the financial statements.

2.1.37 *Entities which disclose in their financial statements a comparison of actual with budgeted amounts are encouraged to include in the financial statements a cross reference to reports which include information about service achievements.*

2.1.38 *Entities which adopt multi-period budgets are encouraged to* provide additional note disclosures *about the relationship between budget and actual amounts during the budget period*.

2.1.39 Additional budget information, including information about service achievements, may be presented in documents other than financial statements. Entities which disclose in their financial statements a comparison of actual with budgeted amounts are encouraged to include in their financial statements a cross reference to such documents, particularly to link budget and actual data to non-financial budget data and service achievements.

2.1.40 As noted in paragraph 1.9.32 of this Standard, entities may take different approaches to determining the annual budget within the multi-period budget. Where multi-period budgets are adopted, entities are encouraged to provide additional disclosures about such matters as the relationship between the multi period budget and component annual budgets and actual amounts during the budget period.

Consolidated Financial Statements

2.1.41 *An entity is encouraged to disclose in the notes to the financial statements:*

(a) *The proportion of ownership interest in controlled entities and, where that interest is in the form of shares, the proportion of voting power held (only where this is different from the proportionate ownership interest);*

(b) *Where applicable:*

(i) *The name of any controlled entity in which the controlling entity holds an ownership interest and/or voting rights of 50% or less, together with an explanation of how control exists; and*

(ii) *The name of any entity in which an ownership interest of more than 50% is held but which is not a controlled entity, together with an explanation of why control does not exist; and*

(c) *In the controlling entity's separate financial statements, a description of the method used to account for controlled entities.*

2.1.42 *A controlling entity which does not present a consolidated statement of cash receipts and payments is encouraged to disclose the reasons why the consolidated financial statements have not been presented together with the bases on which controlled entities are accounted for in its separate financial statements. It is also encouraged to disclose the name and the principal address of its controlling entity that publishes consolidated financial statements.*

2.1.43 Paragraph 1.6.20(b) of Part 1 of this Standard requires that the reasons for non-consolidation of a controlled entity should be disclosed. Paragraphs 1.6.7 and 1.6.8 of Part 1 of the Standard also provide that a controlling entity that is itself a wholly owned entity or a controlling entity that is virtually wholly owned, need not present a consolidated financial statement. When this occurs, the disclosure of the information in paragraph 2.1.42 above is encouraged.

Acquisitions and Disposals of Controlled Entities and Other Operating Units

2.1.44 *An entity is encouraged to disclose and present separately the aggregate cash flows arising from acquisitions and from disposals of controlled entities or other operating units.*

2.1.45 *An entity is encouraged to disclose in the notes to the financial statements, in aggregate in respect of both acquisitions and disposals of controlled entities or other operating units during the period, each of the following:*

(a) *The total purchase or disposal consideration (including cash or other assets);*

(b) *The portion of the purchase or disposal consideration discharged by means of cash; and*

(c) *The amount of cash in the controlled entity or operating unit acquired or disposed of.*

2.1.46 The separate presentation of the cash flow effects of acquisitions and disposals of controlled entities and other operations, together with the separate disclosure of the amounts of assets and liabilities acquired or disposed of, helps to distinguish those cash flows from cash receipts and payments arising from the other activities of the entity. To enable users to identify the effects of both acquisitions and disposals, the cash flow effects of disposals would not be deducted from those acquisitions.

2.1.47 The aggregate amount of the cash paid or received as purchase or sale consideration is reported in the statement of cash receipts and payments net of cash acquired or disposed of.

2.1.48 Paragraph 2.1.33 encourages the disclosure of assets and liabilities of the entity. Assets and liabilities other than cash of a controlled entity or operating unit acquired or disposed of may also be separately disclosed, summarized by each major category. Consistent with the requirement of paragraph 1.3.37 of Part 1 of this Standard, where such disclosure is made, the assets and liabilities should be clearly identified and the basis on which they are recognized and measured explained.

Joint Ventures

2.1.49 *An entity is encouraged to make disclosures about joint ventures which are necessary for a fair presentation of the cash receipts and payments of the entity during the period and the balances of cash as at reporting date.*

2.1.50 Many public sector entities establish joint ventures to undertake a variety of activities. The nature of these activities range from commercial undertakings to provision of community services at no charge. The terms of a joint venture are set out in a contract or other binding arrangement and usually specify the initial contribution from each joint venturer and the share of revenues or other benefits (if any) and expenses of each of the joint venturers. Entities which report on a cash basis will generally report:

(a) As cash payments, the cash expended in the acquisition of an interest in a joint venture and in the ongoing operations of the joint venture; and

(b) As cash receipts, the cash received from the joint venture.

Disclosures about joint ventures may include a listing and description of interests in significant joint ventures. International Public Sector Accounting Standard IPSAS 8, "Financial Reporting of Interests in Joint Ventures" in the accrual based series of IPSASs provides guidance on the different forms and structures that joint ventures may take and potential additional disclosures that might be made.

Financial Reporting in Hyperinflationary Economies

2.1.51 In a hyperinflationary economy, the presentation of the financial statements in the local currency without restatement is not useful. Money loses purchasing power at such a rate that comparison of amounts from transactions and other events that have occurred at different times, even within the same accounting period, is misleading.

2.1.52 This Standard does not identify an absolute rate at which hyperinflation is deemed to arise. It is a matter of judgment when restatement of financial statements in accordance with the encouragements in this Standard would become necessary. Hyperinflation is indicated by characteristics of the economic environment of a country which include, but are not limited to, the following:

(a) The general population prefers to keep its wealth in non-monetary assets or in a relatively stable foreign currency. Amounts of local currency held are immediately invested to maintain purchasing power;

(b) The general population regards monetary amounts not in terms of the local currency but in terms of a relatively stable foreign currency. Prices may be quoted in that currency;

(c) Sales and purchases on credit take place at prices that compensate for the expected loss of purchasing power during the credit period, even if the period is short;

(d) Interest rates, wages and prices are linked to a price index; and

(e) The cumulative inflation rate over three years is approaching, or exceeds, 100%.

The Restatement of Financial Statements

2.1.53 *An entity that reports in the currency of a hyperinflationary economy is encouraged to:*

(a) *Restate its statement of cash receipts and payments and other financial statements in terms of the measuring unit current at the reporting date;*

(b) *Restate the comparative information for the previous period, and any information in respect of earlier periods in terms of the measuring unit current at the reporting date; and*

(c) *Use a general price index that reflects changes in general purchasing power. It is preferable that all entities that report in the currency of the same economy use the same index.*

2.1.54 *The entity is encouraged to make the following disclosures:*

(a) *The fact that the statement of cash receipts and payments and other financial statements, and the corresponding figures for previous periods, have been restated for the changes in the general purchasing power of the reporting currency and, as a result, are stated in terms of the measuring unit current at the reporting date; and*

(b) *The identity and level of the price index at the reporting date and the movement in the index during the current and the previous reporting period.*

2.1.55 Prices change over time as the result of various political, economic and social forces. Specific forces such as changes in supply and demand, and technological changes may cause individual prices to increase or decrease significantly and independently of each other. In addition, general economic forces may result in changes in the general level of prices and therefore in the general purchasing power of money.

2.1.56 In a hyperinflationary economy, the usefulness of financial statements is substantially increased if they are expressed in terms of the measuring unit current at the reporting date. As a result, the treatments and disclosures in paragraphs 2.1.53 and 2.1.54 above are encouraged. Presentation of this information as the primary presentation rather than as a supplement to financial statements which have not been restated is encouraged. Separate presentation of the statement of cash receipts and payments and other financial statements before restatement is discouraged.

2.1.57 All items in the statement of cash receipts and payments will be expressed in terms of the measuring unit current at the reporting date. Therefore, all amounts, including any payments by third parties disclosed on the face of the statement of cash receipts and payments or in other financial statements, would be restated by applying the change in the general price index from the dates when the payments and receipts were initially recorded.

2.1.58 Many entities in the public sector include in their financial statements the related budgetary information, to facilitate comparisons with the budget.

Where this occurs, this Standard encourages restatement of the budgetary information in accordance with this Standard.

Comparative Information

2.1.59 If comparisons with previous periods are to be meaningful, comparative information for the previous reporting period will be restated by applying a general price index so that the comparative financial statements are presented in terms of the measurement unit current at the end of the reporting period. Information that is disclosed in respect of earlier periods is also expressed in terms of the measurement unit current at the end of the reporting period.

Consolidated Financial Statements

2.1.60 A controlling entity that reports in the currency of a hyperinflationary economy may have controlled entities that also report in the currencies of hyperinflationary economies. If the statement of cash receipts and payments and other financial statements are to be prepared on a consistent basis, the financial statements of any such controlled entity will be restated by applying a general price index of the country in whose currency it reports before they are included in the consolidated financial statements issued by its controlling entity. Where such a controlled entity is a foreign controlled entity, its restated financial statements are translated at closing rates.

2.1.61 If financial statements with different reporting dates are consolidated, all items, whether non-monetary or monetary, need to be restated into the measuring unit current at the date of the consolidated financial statement.

Selection and Use of the General Price Index

2.1.62 The restatement of financial statements in accordance with the approach encouraged by this Standard requires the use of a general price index that reflects changes in general purchasing power. It is preferable that all entities that report in the currency of the same economy use the same index.

2.1.63 The disclosures encouraged by this Standard are intended to make clear the basis of dealing with the effects of hyperinflation in the financial statements. They are also intended to provide other information necessary to understand that basis and the resulting amounts.

Assistance Received From Non-Governmental Organizations (NGOs)

2.1.64 *Where practicable, an entity is encouraged to apply to assistance received from non-governmental organizations (NGOs), the required disclosures identified in paragraphs 1.10.1 to 1.10.27 of Part 1 of this Standard and the encouraged disclosures identified in paragraphs 2.1.66 to 2.1.93 below.*

2.1.65 Reporting entities are not required to make the disclosures identified in paragraphs 1.10.1 to 1.10.27 in respect of assistance received from non-governmental organizations (NGOs). This is because the costs of collecting and aggregating the information necessary to comply with those requirements may be greater than its benefits. However, making the disclosures about assistance received from NGOs which are identified in paragraphs1.10.1 to 1.10.27, together with the disclosures encouraged in paragraphs 2.1.66 to 2.1.93 below, can provide additional input to assessments of the extent to which the reporting entity is dependent on assistance from these organizations to support its activities. Accordingly, reporting entities are encouraged to apply the disclosures identified in this Standard to assistance received from NGOs, where it is practicable to do so.

Recipients of External Assistance

2.1.66 *An entity is encouraged to disclose by significant class in notes to the financial statements:*

(a) *The purposes for which external assistance was received during the reporting period, showing separately amounts provided by way of loans and grants; and*

(b) *The purposes for which external assistance payments were made during the reporting period.*

2.1.67 An entity may receive external assistance for many purposes including assistance to support its:

(a) Economic development or welfare objectives, often termed development assistance;

(b) Emergency relief objectives, often termed emergency assistance;

(c) Balance of payments position or to defend its currency exchange rate, often termed balance of payments assistance;

(d) Military and/or defense objectives, often termed military assistance; and

(e) Trading activities, including export credits or loans offered by export/import banks or other government agencies, often termed trade finance.

2.1.68 Part 1 of this Standard requires disclosure of the total amount of external assistance received during the reporting period showing separately the total amount received by way of grants and loans. Disclosure of the significant classes of external assistance received by way of loan or grant will enable users to determine the purposes for which assistance was provided during the period, the amounts thereof and whether the entity has an obligation to repay the assistance provided at some time in the future.

2.1.69 Disclosure by significant class of the purposes for which external assistance payments were made during the reporting period will further enhance the entity's accountability for its use of external assistance received.

2.1.70 *An entity is encouraged to identify in notes to the financial statements each provider of external assistance during the reporting period and the amount provided, excluding any undrawn amounts, showing separately amounts provided by way of loans and grants in the currency provided.*

2.1.71 Disclosure of each provider of external assistance and the amount provided by way of loan and grant will indicate the extent of diversification of sources of assistance. This will assist readers of the financial statements to determine, for example, whether the entity is dependent on particular agencies for assistance, the extent of that dependency and the currency in which it was provided, and whether the assistance is provided by way of a grant or a loan which will need to be repaid in the future. The disclosure encouraged by this paragraph excludes amounts that have not been drawn down during the period. Paragraph 2.1.72 encourages disclosure of information about undrawn amounts of external assistance in certain circumstances.

2.1.72 *In respect of external assistance that is undrawn at reporting date and is disclosed in accordance with paragraph 1.10.18 of Part 1 of this Standard, an entity is encouraged to disclose in notes to the financial statements:*

(a) *Each provider of loan assistance and grant assistance and the amount provided by each;*

(b) *The purposes for which the undrawn loan assistance and undrawn grant assistance may be used;*

(c) *The currency in which the undrawn assistance is held or will be made available; and*

(d) *Changes in the amount of undrawn loan assistance and undrawn grant assistance during the period.*

2.1.73 Undrawn external assistance balances are required to be disclosed in certain circumstances by paragraph 1.10.18 of Part 1 of this Standard. The disclosures encouraged by paragraph 2.1.72 will enable readers of the financial statements to determine the purposes for which such undrawn assistance may be used in the future, the currency in which that undrawn assistance is held or will be made available, and whether the amount of undrawn loan and grant assistance declined or increased during the period.

2.1.74 As is appropriate for the reporting entity, the disclosures could usefully identify such matters as the opening balance of undrawn loans and grants, the amount of new loans and new grants approved or otherwise made available during the period, the total amount of loans and grants drawn or utilized during the period, the total amounts of loans and grants cancelled or expired during the period, and the closing balance of undrawn loans and grants. Such disclosures will assist users in identifying not only the amount of the change in undrawn balances, but also the components of that change.

2.1.75 Where disclosures of changes in the amount of undrawn assistance are made in the entity's reporting currency, external assistance denominated in a foreign currency will be reported in the entity's reporting currency by applying to the foreign currency amount the exchange rate on the date of each applicable transaction, consistent with the requirements of Part 1 of this Standard.

2.1.76 *An entity is encouraged to disclose in notes to the financial statements the terms and conditions of external assistance agreements that determine or affect access to, or limit the use of, external assistance.*

2.1.77 Some external assistance agreements limit or specifically define the use or purpose for which the external assistance may be used, or limit the sources from which goods or services may be purchased. This type of external assistance term or condition may specify that the funds are available only to purchase specific inputs for the construction of specified facilities at a specified location, or that the goods or services purchased under the external assistance agreement must originate from a specified country or countries.

2.1.78 Some external assistance may be released on specific dates, or may be released upon the entity:

(a) Undertaking actions specified in an external assistance agreement, such as implementing specific policy changes; or

(b) Achieving ongoing performance targets, such as budget deficit targets or other broad economic objectives, or establishing a financial sector asset recovery or management agency.

2.1.79 Disclosure of terms and conditions that determine or affect access to external assistance will indicate the extent to which external assistance is time bound and/or is dependent upon the entity taking certain actions and achieving certain performance objectives, and what those actions and performance objectives are.

2.1.80 *An entity is encouraged to disclose in notes to the financial statements:*

(a) *The outstanding balance of any external assistance loans for which principal and/or interest payments have been guaranteed by third parties, any terms and conditions related to those loans, and any additional terms and conditions arising from the guarantee; and*

(b) *The amount and terms and conditions of external assistance loans and grants for which performance of related terms and conditions have been guaranteed by third parties, and any additional terms and conditions arising from the guarantee.*

2.1.81 The balance of external assistance loans borrowed by an entity and payment of interest thereon may be guaranteed, in total or up to a specified amount. Terms and conditions associated with the loans may also require the recipient to take certain actions, or achieve agreed outcomes such as setting tariffs according to an agreed formula, the performance of which are guaranteed by third parties. External assistance grants may also be subject to similar terms and conditions, the performance of which are guaranteed by third parties.

2.1.82 Disclosure of the amounts of external assistance loans and grants guaranteed by third parties will indicate the extent of support from another entity to obtain the benefits of the external assistance agreement. Disclosure of the terms and conditions of external assistance loans and grants that have been guaranteed, and any additional terms and conditions imposed to effect that guarantee, will indicate the additional performance requirements or conditions that arise as a consequence of securing the guarantee.

2.1.83 *An entity is encouraged to disclose in notes to the financial statements other significant terms and conditions associated with external assistance loans, grants or guarantees that have not been complied with, together with the consequence of the non compliance.*

2.1.84 Paragraph 1.10.25 of Part 1 of this Standard requires the disclosure of significant terms and conditions that have not been complied with when non compliance has resulted in cancellation of the assistance or given rise to an obligation to return assistance previously provided. External assistance agreements may also include other significant terms and conditions that are to be complied with, as well as some procedural terms and conditions. Consequences of non compliance with these other significant terms and conditions may include a reduction in the amount, or variation in the timing, of funds that may be drawn or made available in the future until the default is corrected. They may also include an increase in the interest rate charged on loan funds.

2.1.85 Identifying these other significant terms and conditions which have not been complied with is likely to require professional judgment. That judgment will be exercised in the context of the entity's particular circumstances and by reference to the qualitative characteristics of financial statements. These terms and conditions are likely to be those where non compliance is likely to affect the amount or timing of funds that will be available to support the entity's future operations.

2.1.86 *An entity is encouraged to disclose in the notes to the financial statements, a summary of the repayment terms and conditions of outstanding external assistance debt. Where disclosures of future debt service payments denominated in a foreign currency are made, the entity is encouraged to report them in the entity's reporting currency by applying to the foreign currency amount of those payments the closing rate.*

2.1.87 External assistance debt agreements will include terms and conditions relating to such matters as the grace period, interest rate, current debt service payments, future debt service payments, remaining term of the loan, currency of debt service payments, principal repayment requirements (where repayment of the principal is deferred until the end of the loan term, or some other future date), and other significant repayment terms.

2.1.88 Debt service payments may be a significant cash outlay for the entity and will impact on cash available to fund current and additional operations. Disclosure of repayment terms and conditions of outstanding external assistance debt will enable readers of the financial statements to determine when debt service payments (principal and interest or service charges) will commence, and the amount of principal and interest or service charge payable.

2.1.89 Disclosure of information about repayment terms and conditions may require the estimation of, for example, the interest rate to be applied to variable rate debt. The estimated interest rate will usually be determined by reference to applicable interest rates at the closing date. In accordance with the requirements of paragraphs 1.3.30 to 1.3.37 of Part 1 of this Standard, when an entity elects to make disclosures which involve estimates, the accounting policies selected and applied in developing such estimates will be disclosed where necessary for a proper understanding of the financial statements.

2.1.90 *An entity is encouraged to disclose separately in the notes to the financial statements the value of external assistance received in the form of goods or services.*

2.1.91 Significant resources may be received under external assistance agreements in the form of goods or services. This will occur when new or used goods such as vehicles, computers or other equipment are transferred to the entity under an external assistance agreement. It will also occur when food aid is provided to a government for distribution to its citizens under an external assistance agreement. For some recipients, goods or services may be the major form in which external assistance is received.

2.1.92 Disclosure of the value of external assistance received as goods and services will assist readers of the financial statements to better understand the full extent of external assistance received during the reporting period. However, in some cases and for some recipients, determining the value of such goods and services can be a difficult, time consuming and costly process. This is particularly so where a domestic market price for those goods and services cannot be readily determined, where the goods and services provided are not widely traded in international markets or where they are of an unique nature, such as often occurs in respect of emergency assistance.

2.1.93 This Standard does not specify the basis on which the value of the goods or services is to be determined. Therefore, their value may be determined as the depreciated historical cost of physical assets at the time the assets are transferred to the recipient or the price paid for the food by the external assistance agency. It may also be determined on the basis of an assessment of the value by management of the transferor, or the recipient, or by a third party. Where the value of external assistance in the form of goods or services is disclosed, paragraph 1.10.21 of Part 1 of this Standard requires the disclosure of the basis on which that value is determined. Where such is described as fair value it will conform with the definition of fair value—that is, the amount for which an asset could be exchanged, or a liability settled, between knowledgeable and willing parties in an arm's length transaction.

2.2 Governments and Other Public Sector Entities Intending to Migrate to the Accrual Basis of Accounting

Presentation of the Statement of Cash Receipts and Payments

2.2.1 *An entity which intends to migrate to the accrual basis of accounting is encouraged to present a statement of cash receipts and payments in the same format as that required by International Public Sector Accounting Standard (IPSAS 2), "Cash Flow Statements."*

2.2.2 IPSAS 2 provides guidance on classifying cash flows as operating, financing and investing and includes requirements for preparing a statement of cash flows which reports these classes separately on the face of the statement. A summary of key aspects of IPSAS 2 and guidance on their application for financial reporting under this Standard is included in Appendix 3. Part 2 of this Standard encourages disclosure of information additional to that required by IPSAS 2. Entities which adopt the format of IPSAS 2 for the presentation of the statement of cash receipts and payments are encouraged to also make the additional disclosures identified in Part 2 of this Standard.

Scope of Consolidated Statements—Exclusions from the Economic Entity

2.2.3 When an entity adopts the accrual basis of accounting in accordance with the accrual IPSASs, it will not consolidate entities in which control is intended to be temporary because the controlled entity is acquired and held exclusively with a view to its subsequent disposal in the near future. Temporary control may occur where, for example, a national government intends to transfer its interest in a controlled entity to a local government.

2.2.4 Part 1 of this Standard does not provide for such entities to be excluded from the consolidated financial statements prepared under the cash basis. This is because:

(a) The cash of an entity which is controlled on only a temporary basis can be used for the benefit of the economic entity during the period of temporary control; and

(b) The potentially complex consolidation adjustments that may be necessary under the accrual basis will not arise under the cash basis.

2.2.5 For this exemption from consolidation to apply under the accrual IPSASs, the controlling entity must be demonstrably committed to a formal plan to dispose of, or no longer control, the entity that is subject to temporary control. For the exemption to apply at more than one successive reporting date, the controlling entity must demonstrate an ongoing intent to dispose of, or no longer control, the entity that is subject to temporary control. An entity is demonstrably committed to dispose of, or no longer control, another entity when it has a formal plan to do so and there is no realistic possibility of withdrawal from that plan.

2.2.6 Entities preparing to migrate to the accrual basis will need to be aware of this difference in consolidation requirements of the accrual and cash basis IPSASs, and to determine whether, for any controlled entities included in the consolidated statement of receipts and payments, control is temporary.

Appendix 2

Illustration of Certain Disclosures Encouraged in Part 2 of the Standard

This appendix is illustrative only. The purpose of the appendix is to illustrate the application of the encouragements and to assist in clarifying their meaning.

Extract from notes to financial statements of Entity ABC

Administered Transactions (paragraph 2.1.15)

Administered transactions comprise cash flows resulting from transactions administered by the Entity as an agent on behalf of the government and specific government bodies. All cash collected in the capacity of an agent is deposited in the consolidated revenue fund and/or trust account (name of account), as appropriate. These accounts are not controlled by the Entity and the cash deposited in them cannot be used by the Entity without specific authorization by the relevant government body.

(in thousands of currency units)	**Nature of Transaction**	**200X**	**200X-1**
Cash collected on behalf of			
The Executive/Crown	Collection of taxation	X	X
Agency EF	Collection of utility service fee	X	X
		X	X
Cash transferred to respective entities		(X)	(X)
		-	-

Related Party Transactions (paragraph 2.1.31)

The key management personnel (as defined by IPSAS 20, "Related Party Disclosures") of Entity ABC are the Minister, the members of the governing body and the members of the senior management group. The governing body consists of members appointed by Government A. The chief executive officer and the chief financial officer attend meetings of the governing body but are not members of the governing body. The Minister is not remunerated by Entity ABC. The aggregate remuneration of members of the governing body and the number of members determined on a full time equivalent basis receiving remuneration within this category, are:

Aggregate remuneration	AX million.
Number of persons	AY persons.

The senior management group consists of the Entity's chief executive officer, the chief financial officer, and the heads of division. The aggregate remuneration of members of the senior management group and the number of managers determined on a full-time equivalent basis receiving remuneration within this category are:

Aggregate remuneration	AP million.
Number of persons	AQ persons.

Extract from notes to financial statements of Government X

Assets and Liabilities (paragraph 2.1.33(a))

Property, plant and equipment

The Government commenced the process of identifying and valuing major classes of its property, plant and equipment. The assets are stated at historical cost or valuation. The valuations were performed by an independent professional valuer. The valuation bases used for each class of assets are as follows:

Plant and Equipment	Cost
Land	Current Value
Buildings	Cost or Market Value

(in thousands of currency units)	**200X**	**200X-1**
Plant and equipment	X	X
Land and buildings		
Property within city limits	X	X
Buildings at cost	X	X
Buildings at valuation	X	X
	X	X

(*Extract from notes to financial statements of Government X: Assets and Liabilities (paragraph 2.1.33(a) continued)*

Borrowings

The borrowings of the Government are listed below:

(in thousands of currency units)	**200X**	**200X-1**
Balance at beginning of year	X	X
PROCEEDS		
Domestic Commercial Institution	X	X
Offshore Commercial Institution	X	X
Development Banks and Similar Lending Agencies	X	X
Total borrowings	**X**	**X**
REPAYMENTS		
Domestic Commercial Institution	(X)	(X)
Offshore Commercial Institution	(X)	(X)
Development Banks and Similar Lending Agencies	(X)	(X)
Total repayments	**(X)**	**(X)**
Balance at end of year	X	X

(*Extract from notes to financial statements of Government X continued*)

Comparison with budget when the entity does not make its budget publicly available (paragraph 2.1.33 (b))

(in thousands of currency units)	Actual		Budgeted		Variance	
RECEIPTS						
Taxation						
Income tax	X		X		X	
Value-added tax	X		X		(X)	
Property tax	X		X		X	
Other taxes	X		X		(X)	
		X		X		X
Aid Agreements						
International agencies	X		X		-	
Other Grants and Aid	X		X		-	
		X		X		-
Borrowings						
Proceeds from borrowings		X		X		(X)
Capital Receipts						
Proceeds from disposal of plant and equipment		X		X		X
Trading Activities						
Receipts from trading activities		X		X		X
Other receipts		X		X		X
Total receipts		**X**		**X**		**X**
PAYMENTS						
Operations						
Wages, salaries and employee benefits	(X)		(X)		(X)	
Supplies and consumables	(X)		(X)		X	
		(X)		(X)		(X)
Transfers						
Grants	(X)		(X)		-	
Other transfers	(X)		(X)		-	
		(X)		(X)		-
Capital Expenditures						
Purchase/construction of plant and equipment	(X)		(X)		(X)	
Purchase of financial instruments	(X)		(X)		-	
		(X)		(X)		(X)

(in thousands of currency units)	Actual	Budgeted	Variance
Loan and Interest Repayments			
Repayment of borrowings	(X)	(X)	-
Interest payments	(X)	(X)	-
	(X)	(X)	-
Other payments	(X)	(X)	X
Total payments	**(X)**	**(X)**	**(X)**
NET RECEIPTS/(PAYMENTS)	**X**	**X**	**X**

Extract from notes to financial statements of Entity XYZ

Controlled Entities (paragraphs 2.1.41, 2.1.44, and 2.1.45)

Entity XYZ has the power to govern the financial and operating policies so as to benefit from the activities of other entities. These are controlled entities. All controlled entities are included in the consolidated financial statements. (Paragraph 1.6.20(a) in Part 1 of this Standard requires that a list of significant controlled entities be disclosed.)

Control of government entities arises by way of statute or other enabling legislation. Control of government business enterprises arises by way of statute and in the case of Enterprise C and D, by way of ownership interest. Entity XYZ retains control of Enterprise E through legislative authority although the majority of the equity of Enterprise E has been sold to private investors.

Enterprise	Ownership Interest (%)	Voting Power (%)
Enterprise E	XX	XX

Acquisitions of Controlled Entities and Operating Units

Names of Enterprises acquired	Proportion of shares acquired %	Purchase consideration (in thousands of currency units)	Cash portion of purchase consideration (in thousands of currency units)	Cash balances acquired (in thousands of currency units)
Enterprise C	XX	X	X	X
Enterprise D	XX	X	X	X
		X	X	X

(Extract from notes to financial statements of Entity XYZ continued)

Disposals of Controlled Entities and Other Operating Units

Name of Enterprise disposed of	Proportion of shares disposed of %	Disposal consideration (in thousands of currency units)	Cash portion of disposal consideration (in thousands of currency units)	Cash balance disposed of (in thousands of currency units)
Enterprise F	XX	X	X	X

Significant Joint Ventures (paragraph 2.1.49)

Name of Joint Venture	Principal Activity	Output Interest	
		200X %	200X-1 %
Regional Water Board	Water provision	XX	XX
Regional Electricity Board	Provision of utility services	XX	XX

Extract from notes to financial statements of Government B:

Biennial Budget On Cash Basis - For The Year Ended December 31, 200X (paragraph 2.1.38)

(in thousands of currency units)	**Original Biennial Budget Year**	**Target Budget for 1st Year**	**Revised Budget in 1st Year**	**1st Year Actual on Comparable Basis**	**Balance Available for 2nd Year**	**Target Budget for 2nd Year**	**Revised Budget in 2nd Year**	**2nd Year Actual on Comparable Basis**	**Difference: Budget and Actual for Budget Period*
CASH INFLOWS									
Taxation	X	X	X	X	X	X	X	X	X
Aid agreements	X	X	X	X	X	X	X	X	X
Proceeds: borrowing	X	X	X	X	X	X	X	X	X
Proceeds: disposal of plant and equipment	X	X	X	X	X	X	X	X	X
Other receipts	X	X	X	X	X	X	X	X	X
Total inflows	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
CASH OUTFLOWS									
Health	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Education	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Public order and safety	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)

* This column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

(in thousands of currency units)	**Original Biennial Budget Year**	**Target Budget for 1st Year**	**Revised Budget in 1st Year**	**1st Year Actual on Comparable Basis**	**Balance Available for 2nd Year**	**Target Budget for 2nd Year**	**Revised Budget in 2nd Year**	**2nd Year Actual on Comparable Basis**	*Difference: Budget and Actual for Budget Period* *
Social protection	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Defense	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Housing, community amenities	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Recreational, cultural, religion	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Economic affairs	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Other	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)	(X)
Total outflows	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**	**(X)**
NET CASH FLOW	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**

* This column is not required. However, a comparison between actual and the original or the final budget, clearly identified as appropriate, may be included.

Extract From Notes to the Financial Statements of Government C

Assistance Provided by Non-Governmental Organizations (NGOs) *(Paragraph 2.1.64)*

Assistance from NGOs is included in the amount of "Other Grants and Aid" in the Statement of Cash Receipts and Payments. The amount of assistance from NGOs received during the reporting period in the reporting currency is:

	200X		**200X-1**	
	Cash Receipts	**Payments by third parties**	**Cash Receipts**	**Payments by third parties**
Grant Funds	X	X	X	-
Loan Funds	-	-	-	-
Total	**X**	**X**	**X**	**-**

Assistance was received from NGOs under agreements specifying that the assistance would be utilized for the following purposes:

	Development Assistance		**Emergency Assistance**		**Other**		**Total**	
	200X	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**
NGO 1	X	X	-	-	-	X	X	X
NGO 2	-	-	X	-	-	-	X	-
NGO 3	X	X	X	-	-	-	X	X
Total	**X**	**X**	**X**	**-**	**-**	**X**	**X**	**X**
USD	X	X	X	X	-	X	X	X
Euro	X	X	X	-	-	-	X	X
Yen	-	-	X	X	-	-	X	X

The currency in which external assistance was provided was as follows:

- NGO 1 – US Dollars to the amount of YYY and other currency being (specify currency) to the amount of X
- NGO 2 – Euros to the amount of YYY
- NGO 3 – Yen to the amount of YYY

The assistance was fully used for the purposes specified.

While NGO 1, 2 and 3 have indicated their intention to provide ongoing emergency assistance as the need arises and their resources allow, the extent of the assistance is not subject to binding written agreements. It will be determined on the basis of an assessment of needs and the capacity of each NGO to provide ongoing assistance.

During 200X, NGO 1 provided medical teams and medical equipment in support of earthquake victims in the ZZZ region. Temporary shelter, food and clothing were also supplied by NGO 2. The value of the goods and services received has been estimated at XX domestic currency units. The value of the specialized emergency assistance provided has been determined based on cost estimates provided by the NGOs involved.

There have been no instances of non compliance with terms and conditions which have resulted in cancellation of assistance grants.

There were no amounts of undrawn assistance from NGOs in 200X or 200X-1.

Extract From Notes to the Financial Statements of Government C

Classes of External Assistance *(Paragraph 2.1.66 and 2.1.70)*

During the reporting period external assistance was received from multilateral and bilateral external assistance agencies under agreements specifying that the assistance would be utilized for the following purposes:

	Development Assistance		**Emergency Assistance**		**Other**		**Total**	
	200X	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**
Loan Funds	X	X	-	-	X	-	X	X
Grant Funds	X	-	X	X	-	-	X	X
Total	**X**	**X**	**X**	**X**	**X**	-	**X**	**X**
Amount utilized	**X**	**X**	**X**	**X**	**X**	**-**	**X**	**X**

	Agency 1		**Agency 2**		**Agency 3**		**Agency 4**	
	200X	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**
Loan Funds	X	X	-	-	X	-	X	X
Grant Funds	X	-	X	X	-	X	X	X
Total	**X**	**X**	**X**	**X**	**X**	**X**	**X**	**X**
Currency: US Dollar	X	X	-	-	-	-	-	-
Euro	-	-	X	X	-	-	-	-
Yen	-	-	-	-	X	X	-	-
Other	-	-	-	-	-	-	X	X

Undrawn External Assistance *(Paragraph 2.1.72)*

Undrawn external assistance loans and grants consist of amounts which have been specified in a binding agreement with external assistance agencies but have not been utilized at reporting date, and are subject to terms and conditions that have been satisfied in the past and it is anticipated will be satisfied in the future. External assistance loans cancelled or expired resulted from overestimation of the cost of development projects. Changes in the amount of undrawn assistance loans and grants are presented in the entity's reporting currency.

	Development Assistance		**Emergency Assistance**		**Other**		**Total**	
	200X	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**
Opening balance								
Loans	X	X	-	-	X	X	X	X
Grants	X	X	-	X	-	-	X	X
Approved in period								
Loans	X	X	-	-	X	-	X	X
Grants	X	X	X	X	X	X	X	X
Total available	X	X	X	X	X	X	X	X
Loans drawn down	(X)	(X)	-		(X)	(X)	(X)	-
Grants drawn down	(X)	(X)	(X)	(X)	-	-	(X)	(X)
Loans cancelled/expired	(X)	(X)	-	-	-	-	(X)	(X)
Grants cancelled/expired	-	-	-	-	-	-	-	-
Exchange difference	X	X	-	-	X	X	X	X
Closing balance - Loans	X	X	-	-	X	X	X	X
Closing balance - Grants	X	X	-	-	X	X	X	X

Closing balance	Development Assistance		Emergency Assistance		Other		Total	
By currency held	**200X**	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**	**200X**	**200X-1**
US Dollar	X	X	-	X	X	X	X	X
Euro	X	X	-	X	X	X	X	X
Yen	X	X	-	-	X	X	X	X
Other	X	X	-	-	-	-	X	-
By reporting currency								
Loans								
Agency 1	X	X	-	-	X	X	X	X
Agency 4	X	X	-	-	X	X	X	X
Grants								
Agency 2	X	X	-	X	X	X	X	X
Agency 4	X	X	-	X	X	X	X	X
Total	**X**	**X**	**-**	**X**	**X**	**X**	**X**	**X**

Significant terms and conditions (*Paragraph 2.1.76)*

General Restrictions

The balance of commitments for, and undrawn balances of, external assistance is subject to, or restricted by, performance of agreed actions or the maintenance of agreed economic or financial performance levels.

The Government has prepared an economic development plan for receipt of development assistance. The plan includes a poverty reduction strategy which is supported by the donor community. The Government and the donors have agreed the following major targets within the poverty reduction strategy: (Entity to identify major targets).

The Government and the donor community have agreed on methods to monitor progress to achieve the agreed targets and will meet annually to review progress.

Loans and grants to support specific projects include financial performance targets for all electricity and water utilities to ensure adequate revenue to cover the cost of providing services, to properly maintain existing utility assets and to contribute to a program of asset replacement and renewal.

Procurement Restrictions

Certain development assistance received is subject to restrictions in regards to the nature of goods or services that may be purchased or the country in which the goods or services may be purchased. All multilateral development bank loans or grants are restricted in that (a) they prohibit the use of their funds for the purchase of military goods or services, luxury goods or environmentally damaging goods; and (b) the purchase of goods or services must be from their respective member countries. External assistance from bilateral agencies is either unrestricted or limited to purchases of goods or services from the country providing the funds. All “Specific Purpose Loans or Grants” fund specifically defined projects and, as such, the procurement of goods and services is restricted to the agreed inputs for each project.

Non Compliance with other significant terms and conditions *(Paragraph 2.1.83)*

The Government’s expenditures in the education sector did not meet the target level primarily due to construction delays caused by an earthquake. Expenditures were X percent below the target. Steps have been taken to correct the under investment in the education sector and the Government and the relevant donors support the corrective actions planned. The Government has complied with all procurement regulations applicable under all outstanding external assistance loans and grants.

Guarantees of external assistance loans and grants (*Paragraph 2.1.80)*

The Government of YYYY has guaranteed an outstanding export financing loan in the amount of currency units XXX (200X-1: Nil). The principal is to be repaid in 5 years. The interest rate applicable to the outstanding balance is Y percent. Annual, interest only service payments are to be made. No additional terms or conditions arise from the guarantee. No other external assistance loans or grants are subject to guarantees by third parties.

Repayment Terms and Conditions—Debt Service Obligations *(Paragraph 2.1.86)*

The terms of development assistance loans include grace periods which range from 0 to a maximum of 7 years. Interest rates include both fixed rates and variable rates. All development assistance loans are denominated in US Dollars or Euros. Interest rates on fixed rate loans as at fiscal year ending 200X, range from X percent to Y percent with a weighted average of Z percent. For the fiscal year ending 200X-1, they range from X percent to Y percent with a weighted average of Z percent. Interest rates on variable rate loans range from LIBOR plus X percent to LIBOR plus Y percent with a weighted average at the end of fiscal year 200X of Z percent and at the end of fiscal year 200X-1 of Z percent.

Other external assistance loans do not include a grace period, and are denominated in a range of currencies including US Dollars, Euros and Yen.

	200X			
	Outstanding Debt by Remaining Grace Period Years			
	Expired	**0 – 4**	**5 – 7**	**Total**
Development Assistance	X	X	X	X
Other	X	-	-	X
Total	X	X	X	X

	200X-1			
	Outstanding Debt by Remaining Grace Period Years			
	Expired	**0 – 4**	**5 – 7**	**Total**
Development Assistance	X	X	X	X
Other	X	-	-	X
Total	X	X	X	X

Development assistance loans have repayment periods varying from X years to Y years subsequent to the grace period with a weighted average for outstanding debt of Z years including the grace period. In all cases, the debt service is based on a fixed payment of principal plus interest accrued.

Other external assistance loans have repayment periods varying from X to Y years with a weighted average of Z years. Debt service is based on a fixed payment of principal plus interest accrued.

200X

Debt Service Payments Including Interest

	US Dollar	Euro	Yen	Other	Total
Development Assistance	X	X	X	X	X
Other	X	X	-	-	X
Total	X	X	X	X	X

200X-1

Debt Service Payments Including Interest

	US Dollar	Euro	Yen	Other	Total
Development Assistance	X	X	X	X	X
Other	X	X	-	-	X
Total	X	X	X	X	X

All debt service payments for subsequent years are based on payment of a fixed amount comprising principal plus accrued interest. The interest payment or service charge component is based on the outstanding principal of each loan at the end of the current year, and for variable interest rate loans, at interest rates prevailing at that date. Debt service payments denominated in foreign currency have been determined by applying the closing rate of exchange on the reporting date of the financial statements.

200X + 1 and X Subsequent Years

Debt Service Payments Including Interest

	US Dollar	Euro	Yen	Other	Total
Development Assistance	X	X	X	X	X
Other	X	X	-	-	X
Total	X	X	X	X	X

Receipt of Goods and Services *(Paragraph 2.1.90 and 1.10.21)*

During 200X, a severe earthquake occurred in the ZZZ region inflicting serious damage to government property and private property, and significant loss of life. Multilateral agencies and bilateral agencies of several nations donated personnel and equipment to assist in locating and rescuing individuals trapped in the rubble. In addition, specialized medical teams trained in trauma treatment together with medical equipment, were flown into the region. Temporary shelter and food were also supplied. The value of goods and services received has been estimated at XX domestic currency units. The value of the emergency assistance provided has been determined based on cost estimates provided by the bilateral aid agencies involved because local prices for equivalent goods or services were not available.

Fifty thousand tons of rice was received as food aid during the year. It has been valued at XX domestic currency units which represents the wholesale price of similar rice in domestic wholesale markets.

Goods and services received during the year have not been recorded in the Statement of Cash Receipts and Payments, which reflects only cash received (directly or indirectly) or paid by the Government. Goods and services-in-kind were received as part of the emergency assistance and are reflected in this note.

Appendix 3

Presentation of the Statement of Cash Receipts and Payments in the Format Required by IPSAS 2 Statement of Cash Flows

Paragraph 2.2.1 of Part 2 of this Standard encourages an entity which intends to migrate to the accrual basis of accounting to present a statement of cash receipts and payments in the same format as that required by IPSAS 2, "Statement of Cash Flows." IPSAS 2 is applied by an entity which reports on an accrual basis of accounting in accordance with International Public Sector Accounting Standards.

This appendix provides a summary of key aspects of IPSAS 2 and guidance on their application for financial reporting under the cash basis of accounting as required by this Standard. Entities intending to present a statement of cash receipts and payments in accordance with the requirements of IPSAS 2 as far as is appropriate will need to refer to that IPSAS.

Presentation in the Format Required by IPSAS 2 Statement of Cash Flows

1. IPSAS 2 requires an entity which prepares and presents financial statements under the accrual basis of accounting to prepare a cash flow statement which reports cash flows during the period classified by operating, investing and financing activities as defined below.

Definitions

2. *<u>Financing activities</u> are activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.*

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

<u>Operating activities</u> are the activities of the entity that are not investing or financing activities.

Components of the Financial Statements

3. In presenting a statement of cash receipts and payments in this format it may be necessary to classify cash flows arising from a single transaction in different ways. (The term cash flow statement is used in the remainder of this appendix for a statement of cash receipts and payments presented in the same format as that required by IPSAS 2.) For example, when the cash repayment of a loan includes both interest and capital, the interest element may be classified as an operating activity and the capital element may be classified as a financing activity. An entity presenting information by way of a cash flow statement presents its cash flows from operating, investing and financing activities in a manner which is most appropriate to its activities.

4. A cash flow statement will include line items which present the following amounts:

   (a) Total receipts from operating activities;

   (b) Total payments on operating activities;

   (c) Net cash flows from operating activities;

   (d) Net cash flows from investing activities;

   (e) Net cash flows from financing activities;

   (f) Beginning and closing balances of cash; and

   (g) Net increase or decrease in cash.

   Additional line items, headings and sub-totals will also be presented on the face of the statement when such presentation is necessary to present fairly the entity's cash flows.

5. An entity will also present on the face of the cash flow statement or in the notes:

   (a) Major classes of gross cash receipts and gross cash payments arising from operating, investing and financing activities, except to the extent that paragraph 1.3.13 of Part 1 of this Standard allows reporting on a net basis;

   (b) A sub-classification of total cash receipts from operations in a manner appropriate to an entity's operations; and

   (c) An analysis of payments on operating activities using a classification based on either the nature of payments or their function within the entity, as appropriate.

   Separate disclosure of payments made for capital acquisitions and for interest and dividends is also consistent with the requirements of IPSAS 2.

6. Disclosure of information about such matters as whether cash is generated from taxes, fines, fees (operating activities), the sale of capital assets (investing activities) and/or borrowings (financing activities) and whether it was expended to meet operating costs, for the acquisition of capital assets (investing activities) or for the retirement of debt (financing activities) will enhance transparency and accountability of financial reports. These disclosures will also facilitate more informed analysis and assessments of the entity's current cash resources and the likely sources and sustainability of future cash inflows. Accordingly, this Standard encourages all entities to disclose this information in the financial statements and/or related notes.

Operating Activities

7. The amount of net cash flows arising from operating activities is a key indicator of the extent to which the operations of the entity are funded:

   (a) By way of taxes (directly and indirectly); and

   (b) From the recipients of goods and services provided by the entity.

   The disclosure of the amount of net cash flows from operating activities also assists in identifying the extent to which operations of the entity generate cash that can be deployed to repay obligations, pay a dividend/distribution to its owner and make new investments without recourse to external sources of financing. The consolidated whole-of-government operating cash flows provide an indication of the extent to which a government has financed its current activities through taxation and charges. Information about the specific components of historical operating cash flows is useful, in conjunction with other information, in forecasting future operating cash flows.

8. Cash flows from operating activities are primarily derived from the principal cash-generating activities of the entity. Examples of cash flows from operating activities are:

   (a) Cash receipts from taxes, levies and fines;

   (b) Cash receipts from charges for goods and services provided by the entity;

   (c) Cash receipts from grants, or transfers and other appropriations or budget authorizations made by central government or other public sector entities, including those made for the acquisition of capital assets;

   (d) Cash receipts from royalties, fees and commissions;

   (e) Cash payments to other public sector entities to finance their operations (not including loans or equity injections);

   (f) Cash payments to suppliers for goods and services;

   (g) Cash payments to and on behalf of employees;

   (h) Cash receipts and cash payments of a public sector insurance entity for premiums and claims, annuities and other policy benefits;

   (i) Cash payments of local property taxes or income taxes (where appropriate) in relation to operating activities;

   (j) Cash receipts and payments from contracts held for dealing or trading purposes;

   (k) Cash receipts or payments from discontinuing operations; and

   (l) Cash receipts or payments in relation to litigation settlements.

9. An entity may hold securities and loans for dealing or trading purposes, in which case they are similar to inventory acquired specifically for resale. Therefore, cash flows arising from the purchase and sale of dealing or trading securities are classified as operating activities. Similarly, cash advances and loans made by public financial institutions are usually classified as operating activities since they relate to the main cash-generating activity of that entity.

10. In some jurisdictions, governments or other public sector entities will appropriate or authorize funds to entities to finance the operations of the entity, and no clear distinction is made for the disposition of those funds between current activities, capital works and contributed capital. Where an entity is unable to separately identify appropriations or budget authorizations as current activities, capital works (operating activities) and contributed capital (investing activities), IPSAS 2 explains that the entity should classify the appropriation or budget authorization as cash flows from operations, and disclose this in the notes to the statement of cash flows.

Investing Activities

11. The separate disclosure of cash flows arising from investing activities identifies the extent to which cash outflows have been made for resources which are intended to contribute to the entity's future service delivery. Examples of cash flows arising from investing activities are:

    (a) Cash payments to acquire property, plant and equipment, intangibles and other long-term assets. These payments include those relating to capitalized development costs and self-constructed property, plant and equipment;

    (b) Cash receipts from sales of property, plant and equipment, intangibles and other long-term assets;

    (c) Cash payments to acquire equity or debt instruments of other entities and interests in joint ventures (other than payments for those instruments considered to be cash equivalents or those held for dealing or trading purposes);

    (d) Cash receipts from sales of equity or debt instruments of other entities and interests in joint ventures (other than receipts for those instruments considered to be cash equivalents and those held for dealing or trading purposes);

    (e) Cash advances and loans made to other parties (other than advances and loans made by a public financial institution);

    (f) Cash receipts from the repayment of advances and loans made to other parties (other than advances and loans of a public financial institution);

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

(h) Cash receipts from futures contracts, forward contracts, option contracts and swap contracts except when the contracts are held for dealing or trading purposes, or the receipts are classified as financing activities.

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

Financing Activities

12. The separate disclosure of cash flows arising from financing activities is useful in predicting claims on future cash flows by providers of capital to the entity. Examples of cash flows arising from financing activities are:

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

(b) Cash repayments of amounts borrowed;

(c) Cash payments by a lessee for the reduction of the outstanding liability relating to a finance lease; and

(d) Cash receipts and payments relating to the issue of and redemption of currency.

Interest and Dividends

13. IPSAS 2 requires the separate disclosure of cash flows from interest and dividends received and paid. IPSAS 2 also requires that where such disclosures are made they should be classified in a consistent manner from period to period as either operating, investing or financing activities.

14. The total amounts of interest and dividends paid and received during a period are disclosed in the cash flow statement. Interest paid and interest and dividends received are usually classified as operating cash flows for a public financial institution. However, there is no consensus on the classification of the cash flows associated with interest and dividends received and paid for other entities. Interest and dividends paid and interest and dividends received may be classified as operating cash flows. Alternatively, interest and dividends paid and interest and dividends received may be classified as financing cash flows and investing cash flows respectively, because they are costs of obtaining financial resources or returns on investments.

Reporting Major Classes of Receipts and Payments

15. The sub-classification of receipts depends upon the size, nature and function of the amounts involved. Depending upon the nature of the entity, the following sub-classifications may be appropriate:

    (a) Receipts from taxation (these may be further sub-classified into types of taxes);

    (b) Receipts from fees, fines, penalties and licenses;

    (c) Receipts from exchange transactions including receipts from the sale of goods and services and user charges (where these are classified as exchange transactions);

    (d) Receipts from grants, transfers, or budget appropriations (possibly classified by source); and

    (e) Receipts from interest and dividends.

16. Payment items are sub-classified in order to highlight the costs and cost recoveries of particular programs, activities or other relevant segments of the reporting entity. Examples of classification of payments by nature and function are included in Part 1 of this Standard.

Appendix 4

Qualitative Characteristics of Financial Reporting

Paragraph 1.3.32 of Part 1 of this Standard requires that the financial statements provide information that meets a number of qualitative characteristics. This appendix summarizes the qualitative characteristics of financial reporting.

Qualitative characteristics are the attributes that make the information provided in financial statements useful to users. They are applicable to financial statements, regardless of the basis of accounting used to prepare the financial statements. The four principal qualitative characteristics are understandability, relevance, reliability and comparability.

Understandability

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

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

Relevance

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

Materiality

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

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

Reliability

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

Faithful Representation

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

Substance Over Form

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

Neutrality

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

Prudence

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

Completeness

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

Comparability

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

Comparability applies to the:

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

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

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

Constraints on Relevant and Reliable Information

Timeliness

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

Balance between Benefit and Cost

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

Balance between Qualitative Characteristics

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

Appendix 5

Establishing Control of Another Entity for Financial Reporting Purposes

1. Whether an entity controls another entity for financial reporting purposes is a matter of judgment based on the definition of control in this Standard and the particular circumstances of each case. That is, consideration needs to be given to the nature of the relationship between the two entities. In particular, the two elements of the definition of control in this Standard need to be considered. These are the power element (the power to govern the financial and operating policies of another entity) and the benefit element (which represents the ability of the controlling entity to benefit from the activities of the other entity).

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

Control for Financial Reporting Purposes

3. For the purposes of financial reporting, control stems from an entity's power to govern the financial and operating policies of another entity and does not necessarily require an entity to hold a majority shareholding or other equity interest in the other entity. The power to control must be presently exercisable. That is, the entity must already have had this power conferred upon it by legislation or some formal agreement. The power to control is not presently exercisable if it requires changing legislation or renegotiating agreements in order to be effective. This should be distinguished from the fact that the existence of the power to control another entity is not dependent upon the probability or likelihood of that power being exercised.

4. Similarly, the existence of control does not require an entity to have responsibility for the management of (or involvement in) the day-to-day operations of the other entity. In many cases, an entity may only exercise its power to control another entity where there is a breach or revocation of an agreement between a controlled entity and its controlling entity.

5. For example, a government department may have an ownership interest in a rail authority, which operates as a GBE. The rail authority is allowed to operate autonomously and does not rely on the government for funding but

has raised capital through significant borrowings that are guaranteed by the government. The rail authority has not returned a dividend to government for several years. The government has the power to appoint and remove a majority of the members of the governing body of the rail authority. The government has never exercised the power to remove members of the governing body and would be reluctant to do so because of sensitivity in the electorate regarding the previous government's involvement in the operation of the rail network. In this case, the power to control is presently exercisable but under the existing relationship between the controlled entity and controlling entity, an event has not occurred to warrant the controlling entity exercising its powers over the controlled entity. Accordingly, control exists because the power to control is sufficient even though the controlling entity may choose not to exercise that power.

6. The existence of separate legislative powers does not, of itself, preclude an entity from being controlled by another entity. For example, the Office of Government Statistician usually has statutory powers to operate independently of the government. That is, the Office of Government Statistician may have the power to obtain information and report on its findings without recourse to government or any other body. The existence of control does not require an entity to have responsibility over the day-to-day operations of another entity or the manner in which professional functions are performed by the entity.

7. The power of one entity to govern decision-making in relation to the financial and operating policies of another entity is insufficient, in itself, to ensure the existence of control as defined in this Standard. The controlling entity needs to be able to govern decision-making so as to be able to benefit from its activities, for example by enabling the other entity to operate with it as part of an economic entity in pursuing its objectives. This will have the effect of excluding from the definitions of a "controlling entity" and "controlled entity" relationships which do not extend beyond, for instance, that of a liquidator and the entity being liquidated, and would normally exclude a lender and borrower relationship. Similarly, a trustee whose relationship with a trust does not extend beyond the normal responsibilities of a trustee would not be considered to control the trust for the purposes of this Standard.

Regulatory and Purchase Power

8. Governments and government entities have the power to regulate the behavior of many entities by use of their sovereign or legislative powers. Regulatory and purchase powers do not constitute control for the purposes of financial reporting. To ensure that the financial statements of a public sector entity include only those resources (cash, including cash equivalents) that it controls and can benefit from, the meaning of control for the purposes of this Standard does not extend to:

(a) The power of the legislature to establish the regulatory framework within which entities operate and to impose conditions or sanctions on their operations. Such power does not constitute control by a public sector entity of the assets deployed by these entities. For example, a pollution control authority may have the power to close down the operations of entities that are not complying with environmental regulations. However, this power does not constitute control because the pollution control authority only has the power to regulate; or

(b) Entities that are economically dependent on a public sector entity. That is, where an entity retains discretion as to whether it will take funding from, or do business with, a public sector entity, that entity has the ultimate power to govern its own financial or operating policies, and accordingly is not controlled by the public sector entity. For example, a government department may be able to influence the financial and operating policies of an entity which is dependent on it for funding (such as a charity) or a profit-orientated entity that is economically dependent on business from it. Accordingly, the government department has some power as a purchaser but not to govern the entity's financial and operating policies.

Determining Whether Control Exists for Financial Reporting Purposes

9. Public sector entities may create other entities to achieve some of their objectives. In some cases, it may be clear that an entity is controlled, and hence should be consolidated. In other cases it may not be clear. Paragraphs 10 and 11 below provide guidance to help determine whether or not control exists for financial reporting purposes.

10. In examining the relationship between two entities, control is presumed to exist when at least one of the following power conditions and one of the following benefit conditions exists, unless there is clear evidence of control being held by another entity.

Power conditions

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

(b) The entity has the power, either granted by or exercised within existing legislation, to appoint or remove a majority of the members of the governing body of the other entity.

(c) The entity has the power to cast, or regulate the casting of, a majority of the votes that are likely to be cast at a general meeting of the other entity.

(d) The entity has the power to cast the majority of votes at meetings of the board of directors or equivalent governing body.

Benefit conditions

(a) The entity has the power to dissolve the other entity and obtain a significant level of the residual economic benefits or bear significant obligations. For example, the benefit condition may be met if an entity had responsibility for the residual liabilities of another entity.

(b) The entity has the power to extract distributions of assets from the other entity, and/or may be liable for certain obligations of the other entity.

11. When one or more of the conditions listed in paragraph 10 do not exist, the following factors are likely, either individually or collectively, to be indicative of the existence of control.

Power indicators

(a) The entity has the ability to veto operating and capital budgets of the other entity.

(b) The entity has the ability to veto, overrule, or modify governing body decisions of the other entity.

(c) The entity has the ability to approve the hiring, reassignment and removal of key personnel of the other entity.

(d) The mandate of the other entity is established and limited by legislation.

(e) The entity holds a "golden share"1 (or equivalent) in the other entity that confers rights to govern the financial and operating policies of that other entity.

Benefit indicators

(a) The entity holds direct or indirect title to the net assets/equity of the other entity with an ongoing right to access these.

(b) The entity has a right to a significant level of the net assets/equity of the other entity in the event of a liquidation or in a distribution other than a liquidation.

(c) The entity is able to direct the other entity to co-operate with it in achieving its objectives.

(d) The entity is exposed to the residual liabilities of the other entity.

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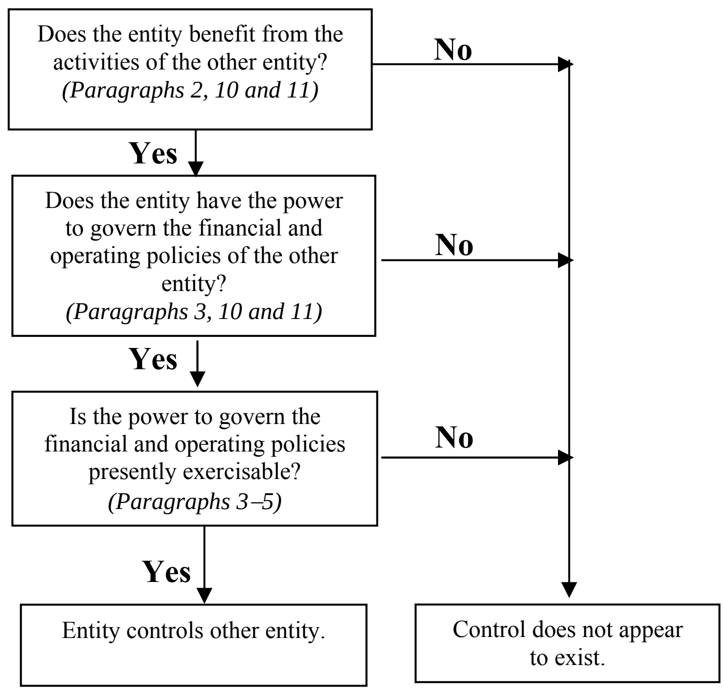
[1] "Golden share" refers to a class of share that entitles the holder to specified powers or rights generally exceeding those normally associated with the holder's ownership interest or representation on the governing body.

12. The following diagram indicates the basic steps involved in establishing control of another entity. It should be read in conjunction with paragraphs 1 to 11 of this appendix.

Establishing Control of another Entity for Financial Reporting Purposes



13. Sometimes a controlled entity is excluded from consolidation when its activities are dissimilar to those of other entities within the economic entity, for example, the consolidation of GBEs with entities in the budget sector. Exclusion on these grounds is not justified because better information would be provided by consolidating such controlled entities and disclosing additional information in the consolidated financial statements about the different activities of controlled entities.

GLOSSARY OF DEFINED TERMS

This Glossary contains all terms defined in the 26 accrual basis International Public Sector Accounting Standards (IPSASs) on issue as at December 31, 2008. A list of these IPSASs is located on the inside back cover of the Glossary. This Glossary does not include terms defined in the Cash Basis IPSAS, “Financial Reporting under the Cash Basis of Accounting.” Users should refer to that Cash Basis IPSAS for these terms.

Where multiple definitions of the same term exist, this Glossary indicates all IPSASs in which the term appears and the definition that applies to that particular IPSAS.

Definitions

References to accrual basis IPSASs are by Standard number and paragraph number. For example, 1.7 refers users to IPSAS 1, “Presentation of Financial Statements,” paragraph 7. References set out in brackets indicate a minor variation in wording.

Term	Definition	Location
accounting basis	The accrual or cash basis of accounting as defined in the accrual basis International Public Sector Accounting Standards and the Cash Basis International Public Sector Accounting Standard.	24.7
accounting policies	The specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements.	3.7, 6.7, 18.8
accrual basis	A basis of accounting under which transactions and other events are recognized when they occur (and not only when cash or its equivalent is received or paid). Therefore, the transactions and events are recorded in the accounting records and recognized in the financial statements of the periods to which they relate. The elements recognized under accrual accounting are assets, liabilities, net assets/equity, revenue and expenses.	1.7, 3.7, 4.10, 5.5, 6.7, 8.6, (2.8)

Term	Definition	Location
active market	A market in which all the following conditions exist: (a) The items traded within the market are homogeneous; (b) Willing buyers and sellers can normally be found at any time; and (c) Prices are available to the public.	21.14
actuarial gains and losses	Comprise: (a) Experience adjustments (the effects of differences between the previous actuarial assumptions and what has actually occurred); and (b) The effects of changes in actuarial assumptions.	25.10
annual budget	An approved budget for one year. It does not include published forward estimates or projections for periods beyond the budget period.	24.7
appropriation	An authorization granted by a legislative body to allocate funds for purposes specified by the legislature or similar authority	24.7
approved budget	The expenditure authority derived from laws, appropriation bills, government ordinances and other decisions related to the anticipated revenue or receipts for the budgetary period.	24.7
assets[1]	Resources controlled by an entity as a result of past events and from which future economic benefits or service potential are expected to flow to the entity.	1.7, 2.8, 5.5, 6.7, 8.6

GLOSSARY

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

Term	Definition	Location
assets held by a long-term employee benefit fund	Assets (other than non-transferable financial instruments issued by the reporting entity) that: (a) Are held by an entity (a fund) that is legally separate from the reporting entity and exists solely to pay or fund employee benefits; and (b) Are available to be used only to pay or fund employee benefits, are not available to the reporting entity's own creditors (even in bankruptcy), and cannot be returned to the reporting entity, unless either: (i) The remaining assets of the fund are sufficient to meet all the related employee benefit obligations of the plan or the reporting entity; or (ii) The assets are returned to the reporting entity to reimburse it for employee benefits already paid.	25.10
associate	An entity, including an unincorporated entity such as a partnership, over which the investor has significant influence and that is neither a controlled entity nor an interest in a joint venture.	6.7, 7.7, 8.6
borrowing costs	Interest and other expenses incurred by an entity in connection with the borrowing of funds.	5.5
budgetary basis	The accrual, cash or other basis of accounting adopted in the budget that has been approved by the legislative body.	24.7
carrying amount (of investment property)	The amount at which an asset is recognized in the statement of financial position.	16.7
carrying amount (of property, plant and equipment)	The amount at which an asset is recognized after deducting any accumulated depreciation and accumulated impairment losses.	17.7

Term	Definition	Location
carrying amount of an asset	The amount at which an asset is recognized in the statement of financial position after deducting any accumulated depreciation and accumulated impairment losses thereon.	10.7, 21.14
carrying amount of a liability	The amount at which a liability is recognized in the statement of financial position.	10.7
cash	Comprises cash on hand and demand deposits.	2.8, 5.5, 6.7, 8.6, 10.7
cash equivalents	Short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.	2.8,
cash flows	Inflows and outflows of cash and cash equivalents.	2.8, 8.6
cash-generating assets	Assets held with the primary objective of generating a commercial return	21.14, 26.13
cash-generating unit	The smallest identifiable group of assets held with the primary objective of generating a commercial return that generates cash inflows from continuing use that are largely independent of the cash inflows from other assets or groups of assets.	26.13
class of property, plant and equipment	A grouping of assets of a similar nature or function in an entity's operations that is shown as a single item for the purpose of disclosure in the financial statements.	17.13
close members of the family of an individual	Close relatives of the individual or members of the individual's immediate family who can be expected to influence, or be influenced by, that individual in their dealings with the entity.	20.4
closing rate	The spot exchange rate at the reporting date.	4.10

Term	Definition	Location
commencement of the lease term	The date from which the lessee is entitled to exercise its right to use the leased asset. It is the date of initial recognition of the lease (i.e., the recognition of the assets, liabilities, revenue or expenses resulting from the lease, as appropriate).	13.8
comparable basis	The actual amounts presented on the same accounting basis, same classification basis, for the same entities and for the same period as the approved budget.	24.7
composite social security programs	Programs established by legislation; and (a) Operate as multi-employer plans to provide post-employment benefits; as well as to (b) Provide benefits that are not consideration in exchange for service rendered by employees.	25.10
conditions on transferred assets	Stipulations that specify that the future economic benefits or service potential embodied in the asset is required to be consumed by the recipient as specified or future economic benefits or service potential must be returned to the transferor.	23.7
consolidated financial statements	The financial statements of an economic entity presented as those of a single entity.	6.7, 6.7, 7.7, 8.6
construction contract	A contract, or a similar binding arrangement, specifically negotiated for the construction of an asset or a combination of assets that are closely interrelated or interdependent in terms of their design, technology and function or their ultimate purpose or use.	11.4

Term	Definition	Location
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.	19.18
contingent asset	A possible asset that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity.	19.18
contingent liability	(a) A possible obligation that arises from past events and whose existence will be confirmed only by the occurrence or non-occurrence of one or more uncertain future events not wholly within the control of the entity; or (b) A present obligation that arises from past events but is not recognized because: (i) It is not probable that an outflow of resources embodying economic benefits or service potential will be required to settle the obligation; or (ii) The amount of the obligation cannot be measured with sufficient reliability.	19.18
contingent rent	That portion of the lease payments that is not fixed in amount but is based on the future amount of a factor that changes other than with the passage of time (e.g., percentage of future sales, amount of future usage, future price indices, future market rates of interest).	13.8

Term	Definition	Location
contractor	An entity that performs construction work pursuant to a construction contract.	11.4
contributions from owners	Future economic benefits or service potential that has been contributed to the entity by parties external to the entity, other than those that result in liabilities of the entity, that establish a financial interest in the net assets/equity of the entity, which: (a) Conveys entitlement both to distributions of future economic benefits or service potential by the entity during its life, such distributions being at the discretion of the owners or their representatives, and to distributions of any excess of assets over liabilities in the event of the entity being wound up; and/or (b) Can be sold, exchanged, transferred or redeemed.	1.7, 2.8, 5.5, 6.7, 8.6
control	The power to govern the financial and operating policies of another entity so as to benefit from its activities.	6.7, 7.7, 8.6
control of an asset	Arises when the entity can use or otherwise benefit from the asset in pursuit of its objectives and can exclude or otherwise regulate the access of others to that benefit.	23.7
controlled entity	An entity, including an unincorporated entity such as a partnership, that is under the control of another entity (known as the controlling entity).	6.7, 8.6, (7.7)
controlling entity	An entity that has one or more controlled entities.	6.7, 7.7, 8.6
cost	The amount of cash or cash equivalents paid or the fair value of the other consideration given to acquire an asset at the time of its acquisition or construction.	16.7, 17.13

Term	Definition	Location
cost method	A method of accounting for an investment whereby the investment is recognized at cost. The investor recognizes revenue from the investment only to the extent that the investor is entitled to receive distributions from accumulated surpluses of the investee arising after the date of acquisition. Entitlements due or received in excess of such surpluses are regarded as a recovery of investment and are recognized as a reduction of the cost of the investment.	7.7
cost plus or cost based contract	A construction contract in which the contractor is reimbursed for allowable or otherwise defined costs and, in the case of a commercially-based contract, an additional percentage of these costs or a fixed fee, if any.	11.4
costs of disposal	Incremental costs directly attributable to the disposal of an asset, excluding finance costs and income tax expense.	21.14
current replacement cost	The cost the entity would incur to acquire the asset on the reporting date.	12.9
current service cost	The increase in the present value of the defined benefit obligation resulting from employee service in the current period.	25.10
defined benefit plans	Post-employment benefit plans other than defined contribution plans.	25.10
defined contribution plans	Post-employment benefit plans under which an entity pays fixed contributions into a separate entity (a fund) and will have no legal or constructive obligation to pay further contributions if the fund does not hold sufficient assets to pay all employee benefits relating to employee service in the current and prior periods.	25.10
depreciable amount	The cost of an asset, or other amount substituted for cost, less its residual value.	17.13

Term	Definition	Location
depreciation (amortization)	The systematic allocation of the depreciable amount of an asset over its useful life.	17.13, 21.14
distribution to owners	Future economic benefits or service potential distributed by the entity to all or some of its owners, either as a return on investment or as a return of investment.	1.7, 2.8, 3.7, 4.10, 5.5, 6.7, 7.7, 8.6
economic entity[1]	A group of entities comprising a controlling entity and one or more controlled entities.	1.7, 2.8, 4.10, 5.5, 6.7, 7.7, 8.6
economic life	Either: (a) The period over which an asset is expected to yield economic benefits or service potential to one or more users; or (b) The number of production or similar units expected to be obtained from the asset by one or more users.	13.8
employee benefits	All forms of consideration given by an entity in exchange for service rendered by employees.	25.10
entity specific value	The present value of the cash flows an entity expects to arise from the continuing use of an asset and from its disposal at the end of its useful life or expects to incur when settling a liability.	17.13
equity instrument	Any contract that evidences a residual interest in the assets of an entity after deducting all of its liabilities.	15.9

[1] *Commentary:* The term economic entity is used in this series of Standards to define, for financial reporting purposes, a group of entities comprising the controlling entity and any controlled entities. Other terms sometimes used to refer to an economic entity include administrative entity, financial entity *(IPSAS 4, "financial reporting entity")*, consolidated entity and group. An economic entity may include entities with both social policy and commercial objectives. For example, a government housing department may be an economic entity which includes entities that provide housing for a nominal charge, as well as entities that provide accommodation on a commercial basis.

Term	Definition	Location
equity method (1)	A method of accounting whereby the investment is initially recognized at cost and adjusted thereafter for the post-acquisition change in the investor's share of net assets/equity of the investee. The surplus or deficit of the investor includes the investor's share of the surplus or deficit of the investee.	1.7, 4.10, 6.7, 7.7
equity method(2)	A method of accounting whereby an interest in a jointly controlled entity is initially recorded at cost and adjusted thereafter for the post-acquisition change in the venturer's share of net assets/equity of the jointly controlled entity. The surplus or deficit of the venturer includes the venturer's share of the surplus or deficit of the jointly controlled entity.	8.6
events after the reporting date	Those events, both favorable and unfavorable, that occur between the reporting date and the date when the financial statements are authorized for issue. Two types of events can be identified: (a) Those that provide evidence of conditions that existed at the reporting date (adjusting events after the reporting date); and (b) Those that are indicative of conditions that arose after the reporting date (non-adjusting events after the reporting date).	14.5
exchange difference	The difference resulting from reporting the same number of units of a foreign currency in the reporting currency at different exchange rates.	1.7, 4.10,
exchange rate	The ratio for exchange of two currencies.	4.10,
exchange transactions	Transactions in which one entity receives assets or services, or has liabilities extinguished, and directly gives approximately equal value (primarily in the form of cash, goods, services, or use of assets) to another entity in exchange.	23.7, 9.11, 12.9, 16.7, 17.13

Term	Definition	Location
executory contracts	Contracts under which neither party has performed any of its obligations or both parties have partially performed their obligations to an equal extent.	19.18
expenses	Decreases in economic benefits or service potential during the reporting period in the form of outflows or consumption of assets or incurrences of liabilities that result in decreases in net assets/equity, other than those relating to distributions to owners.	1.7, 2.8, 3.7, 4.10, 5.5, 6.7, 7.7, 8.6
expenses paid through the tax system	Amounts that are available to beneficiaries regardless of whether or not they pay taxes.	23.7
fair value	The amount for which an asset could be exchanged, or a liability settled, between knowledgeable, willing parties in an arm’s length transaction.	1.7, 4.10, 7.7, 9.11, 15.9, 16.7, 17.13
fair value less costs to sell (of an asset)	The amount obtainable from the sale of an asset in an arm’s length transaction between knowledgeable, willing parties, less the costs of disposal.	21.14
final budget	The original budget adjusted for all reserves, carry over amounts, transfers, allocations, supplemental appropriations, and other authorized legislative , or similar authority, changes applicable to the budget period	24.7
finance lease	A lease that transfers substantially all the risks and rewards incident to ownership of an asset. Title may or may not eventually be transferred.	13.8

Term	Definition	Location
financial asset	Any asset that is: (a) Cash; (b) A contractual right to receive cash or another financial asset from another entity; (c) A contractual right to exchange financial instruments with another entity under conditions that are potentially favorable; or (d) An equity instrument of another entity.	1.7, 15.9
financial instrument	Any contract that gives rise to both a financial asset of one entity and a financial liability or equity instrument of another entity. Commodity-based contracts that give either party the right to settle in cash or some other financial instrument should be accounted for as if they were financial instruments, with the exception of commodity contracts that (a) were entered into and continue to meet the entity's expected purchase, sale, or usage requirements, (b) were designated for that purpose at their inception, and (c) are expected to be settled by delivery.	15.9
financial liability	Any liability that is a contractual obligation: (a) To deliver cash or another financial asset to another entity; or (b) To exchange financial instruments with another entity under conditions that are potentially unfavorable. An entity may have a contractual obligation that it can settle either by payment of financial assets or by payment in the form of its own equity securities. In such a case, if the number of equity securities required to settle the obligation varies with changes in their fair value so that the total fair value of the equity securities paid always equals the amount of the contractual obligation, the holder of the obligation is not exposed to gain or loss from fluctuations in the price of its equity securities. Such an obligation should be accounted for as a financial liability of the entity.	15.9

Term	Definition	Location
financing activities	Activities that result in changes in the size and composition of the contributed capital and borrowings of the entity.	2.8, 3.7, 4.10, 18.8
fines	Economic benefits or service potential received or receivable by public sector entities, as determined by a court or other law enforcement body, as a consequence of the breach of laws or regulations.	23.7
fixed price contract	A construction contract in which the contractor agrees to a fixed contract price, or a fixed rate per unit of output, which in some cases is subject to cost escalation clauses.	11.4
foreign currency	A currency other than the functional currency of the entity.	1.7, 4.10,
foreign operation	An entity that is a controlled entity, associate, joint venture or branch of a reporting entity, the activities of which are based or conducted in a country or currency other than those of the reporting entity.	1.7, 3.7, 4.10
functional currency	The currency of the primary economic environment in which the entity operates.	4.10
general government sector	Comprises all organizational entities of the general government as defined in statistical bases of financial reporting	22.15

Term	Definition	Location
Government Business Enterprise[1]	An entity that has all the following characteristics: (a) Is an entity with the power to contract in its own name; (b) Has been assigned the financial and operational authority to carry on a business; (c) Sells goods and services, in the normal course of its business, to other entities at a profit or full cost recovery; (d) Is not reliant on continuing government funding to be a going concern (other than purchases of outputs at arm's length); and (e) Is controlled by a public sector entity.	1.7, 2.8, 5.5, 21.14
gross investment in the lease	The aggregate of: (a) The minimum lease payments receivable by the lessor under a finance lease; and (b) Any unguaranteed residual value accruing to the lessor.	13.8
guaranteed residual value	(a) For a lessee, that part of the residual value that is guaranteed by the lessee or by a party related to the lessee (the amount of the guarantee being the maximum amount that could, in any event, become payable); and (b) For a lessor, that part of the residual value that is guaranteed by the lessee or by a third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee.	13.8

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

Term	Definition	Location
impairment	A loss in the future economic benefits or service potential of an asset, over and above the systematic recognition of the loss of the asset's future economic benefits or service potential through depreciation.	21.14
impairment loss of a cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable amount.	26.13
impairment loss of a non-cash-generating asset	The amount by which the carrying amount of an asset exceeds its recoverable service amount.	21.14
impracticable	Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so.	1.7, 3.7
inception of the lease	The inception of the lease is the earlier of the date of the lease agreement and the date of commitment by the parties to the principal provisions of the lease. As at this date: (a) A lease is classified as either an operating or a finance lease; and (b) In the case of a finance lease, the amounts to be recognized at the commencement of the lease term are determined.	13.8
initial direct costs	Initial direct costs are incremental costs that are directly attributable to negotiating and arranging a lease, except for such costs incurred by manufacturer or trader lessors.	13.8
insurance contract	A contract that exposes the insurer to identified risks of loss from events or circumstances occurring or discovered within a specified period, including death (in the case of an annuity, the survival of the annuitant), sickness, disability, property damage, injury to others and interruption of operations.	15.9

Term	Definition	Location
Interest cost	The increase during a period in the present value of a defined benefit obligation which arises because the benefits are one period closer to settlement.	25.10
interest rate implicit in the lease	The discount rate that, at the inception of the lease, causes the aggregate present value of: (a) The minimum lease payments; and (b) The unguaranteed residual value to be equal to the sum of (i) Fair value of the leased asset; and (ii) Any initial direct costs.	13.8
inventories	Assets: (a) In the form of materials or supplies to be consumed in the production process; (b) In the form of materials or supplies to be consumed or distributed in the rendering of services; (c) Held for sale or distribution in the ordinary course of operations; or (d) In the process of production for sale or distribution.	12.9
investing activities	The acquisition and disposal of long-term assets and other investments not included in cash equivalents.	2.8, 4.10, 18.8
investment property	Property (land or a building – or part of a building – or both) held to earn rentals or for capital appreciation or both, rather than for: (a) Use in the production or supply of goods or services or for administrative purposes; or (b) Sale in the ordinary course of operations.	16.7
investor in a joint venture	Is a party to a joint venture and does not have joint control over that joint venture.	6.7, 7.7, 8.6

Term	Definition	Location
joint control	The agreed sharing of control over an activity by a binding arrangement.	6.7, 8.6
joint venture	A binding arrangement whereby two or more parties are committed to undertake an activity that is subject to joint control.	1.7, 4.10, 6.7, 7.7, 8.6
key management personnel	(a) All directors or members of the governing body of the entity; and (b) Other persons having the authority and responsibility for planning, directing and controlling the activities of the reporting entity. Where they meet this requirement key management personnel include: (i) Where there is a member of the governing body of a whole-of-government entity who has the authority and responsibility for planning, directing and controlling the activities of the reporting entity, that member; (ii) Any key advisors of that member; and (iii) Unless already included in (a), the senior management group of the reporting entity, including the chief executive or permanent head of the reporting entity.	20.4
lease	An agreement whereby the lessor conveys to the lessee in return for a payment or series of payments the right to use an asset for an agreed period of time.	13.8
lease term	The non-cancelable period for which the lessee has contracted to lease the asset together with any further terms for which the lessee has the option to continue to lease the asset, with or without further payment, which option at the inception of the lease it is reasonably certain that the lessee will exercise.	13.8

Term	Definition	Location
legal obligation	An obligation that derives from: (a) A contract (through its explicit or implicit terms); (b) Legislation; or (c) Other operation of law.	19.18
lessee's incremental borrowing rate of interest	The rate of interest the lessee would have to pay on a similar lease or, if that is not determinable, the rate that, at the inception of the lease, the lessee would incur to borrow over a similar term, and with a similar security, the funds necessary to purchase the asset.	13.8
liabilities	Present obligations of the entity arising from past events, the settlement of which is expected to result in an outflow from the entity of resources embodying economic benefits or service potential.	1.7, 2.8, 5.5, 19.18
market value	The amount obtainable from the sale, or payable on the acquisition, of a financial instrument in an active market.	15.9
material	Omissions or misstatements of items are material if they could, individually or collectively, influence the decisions or assessments of users made on the basis of the financial statements. Materiality depends on the nature and size of the omission or misstatement judged in the surrounding circumstances. The nature or size of the item, or a combination of both, could be the determining factor.	1.7, 3.7
minimum lease payments	The payments over the lease term that the lessee is, or can be, required to make, excluding contingent rent, costs for services and, where appropriate, taxes to be paid by and reimbursed to the lessor, together with: (a) For a lessee, any amounts guaranteed by the lessee or by a party related to the	13.8

Term	Definition	Location
	lessee; or (b) For a lessor, any residual value guaranteed to the lessor by either: i. The lessee; ii. A party related to the lessee; or iii. An independent third party unrelated to the lessor that is financially capable of discharging the obligations under the guarantee. However, if the lessee has an option to purchase the asset at a price that is expected to be sufficiently lower than the fair value at the date the option becomes exercisable, for it to be reasonably certain at the inception of the lease, that the option will be exercised, the minimum lease payments comprise the minimum payments payable over the lease term to the expected date of exercise of this purchase option and the payment required to exercise it.	
minority interest	That portion of the net surplus or deficit and of net assets/equity of a controlled entity attributable to net assets/equity interests that are not owned, directly or indirectly through controlled entities, by the controlling entity.	6.7
monetary items	Units of currency held and assets and liabilities to be received or paid in fixed or determinable number of units of currency.	4.10, 10.7
monetary financial assets and financial liabilities (also referred to as monetary financial instruments.)	Financial assets and financial liabilities to be received or paid in fixed or determinable amounts of money.	15.9

Term	Definition	Location
multi-employer plans	Defined contribution plans (other than state plans and composite social security programs) or defined benefit plans (other than state plans) that: (a) Pool the assets contributed by various entities that are not under common control; and (b) Use those assets to provide benefits to employees of more than one entity, on the basis that contribution and benefit levels are determined without regard to the identity of the entity that employs the employees concerned.	25.10
multi-year budget	An approved budget for more than one year. It does not include published forward estimates or projections for periods beyond the budget period.	24.7
net assets/ equity[1]	The residual interest in the assets of the entity after deducting all its liabilities.	1.7, 2.8, 5.5,
net investment in a foreign operation	The amount of the reporting entity's interest in the net assets/equity of that operation.	4.10
net investment in the lease	The gross investment in the lease discounted at the interest rate implicit in the lease.	13.8
net realizable value	The estimated selling price in the ordinary course of operations less the estimated costs of completion and the estimated costs necessary to make the sale, exchange or distribution.	12.9

GLOSSARY

[1] *Commentary:* "Net assets/equity" is the term used in this series of Standards to refer to the residual measure in the statement of financial position (assets less liabilities). Net assets/equity may be positive or negative. Other terms may be used in place of net assets/equity, provided that their meaning is clear.

Term	Definition	Location
non-cancelable lease	A lease that is cancelable only: (a) Upon the occurrence of some remote contingency; (b) With the permission of the lessor; (c) If the lessee enters into a new lease for the same or an equivalent asset with the same lessor; or (d) Upon payment by the lessee of an additional amount such that, at inception, continuation of the lease is reasonably certain.	13.8
non-cash-generating assets	Assets other than cash-generating assets.	21.14, 26.13
non-exchange transactions	Transactions that are not exchange transactions. In a non-exchange transaction, an entity either receives value from another entity without directly giving approximately equal value in exchange, or gives value to another entity without directly receiving approximately equal value in exchange.	23.7, 9.11, 12.9, 16.7, 17.13
non-monetary items	Items that are not monetary items.	10.7
notes	Contain information in addition to that presented in the statement of financial position, statement of financial performance, statement of changes in net assets/equity and cash flow statement. Notes provide narrative descriptions or disaggregations of items disclosed in those statements and information about items that do not qualify for recognition in those statements.	1.7
obligating event	An event that creates a legal or constructive obligation that results in an entity having no realistic alternative to settling that obligation.	19.18

Term	Definition	Location
onerous contract	A contract for the exchange of assets or services in which the unavoidable costs of meeting the obligations under the contract exceed the economic benefits or service potential expected to be received under it.	19.18
operating activities	The activities of the entity that are not investing or financing activities.	2.8, 18.8
operating lease	A lease other than a finance lease.	13.8
original budget	The initial approved budget for the budget period.	24.7
other long-term employee benefits	Employee benefits (other than post-employment benefits and termination benefits) which do not fall due wholly within twelve months after the end of the period in which the employees render the related service.	25.10
oversight	The supervision of the activities of an entity, with the authority and responsibility to control, or exercise significant influence over, the financial and operating decisions of the entity.	20.4
owner-occupied property	Property held (by the owner or by the lessee under a finance lease) for use in the production or supply of goods or services or for administrative purposes.	16.7
past service cost	The increase in the present value of the defined benefit obligation for employee service in prior periods, resulting in the current period from the introduction of, or changes to, post-employment benefits or other long-term employee benefits. Past service cost may be either positive (where benefits are introduced or improved) or negative (where existing benefits are reduced).	25.10

Term	Definition	Location
plan assets	Comprise: (a) Assets held by a long-term employee benefit fund; and (b) Qualifying insurance policies.	25.10
post-employment benefits	Employee benefits (other than termination benefits) which are payable after the completion of employment.	25.10
post-employment benefit plans	Formal or informal arrangements under which an entity provides post-employment benefits for one or more employees.	25.10
present value of a defined benefit obligation	The present value, without deducting any plan assets, of expected future payments required to settle the obligation resulting from employee service in the current and prior periods.	25.10
presentation currency	The currency in which the financial statements are presented.	4.10
prior period errors	Omissions from, and misstatements in, the entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that: (a) Was available when financial statements for those periods were authorized for issue; and (b) Could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements. Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.	

Term	Definition	Location
property, plant and equipment	Tangible items that: (a) Are held for use in the production or supply of goods or services, for rental to others, or for administrative purposes; and (b) Are expected to be used during more than one reporting period.	17.13
proportionate consolidation	A method of accounting whereby a venturer's share of each of the assets, liabilities, revenue and expenses of a jointly controlled entity is combined on a line-by-line basis with similar items in the venturer's financial statements or reported as separate line items in the venturer's financial statements.	8.6
prospective application	Prospective application of a change in accounting policy and of recognizing the effect of a change in an accounting estimate, respectively, are: (a) Applying the new accounting policy to transactions, other events and conditions occurring after the date as at which the policy is changed; and (b) Recognizing the effect of the change in the accounting estimate in the current and future periods affected by the change	3.7
provision	A liability of uncertain timing or amount.	19.18
qualifying asset	An asset that necessarily takes a substantial period of time to get ready for its intended use or sale.	5.5

GLOSSARY

Term	Definition	Location
qualifying insurance policy	An insurance policy issued by an insurer that is not a related party (as defined in IPSAS 20) of the reporting entity, if the proceeds of the policy: (a) Can be used only to pay or fund employee benefits under a defined benefit plan; and (b) Are not available to the reporting entity's own creditors (even in bankruptcy) and cannot be paid to the reporting entity, unless either: (i) The proceeds represent surplus assets that are not needed for the policy to meet all the related employee benefit obligations; or (ii) The proceeds are returned to the reporting entity to reimburse it for employee benefits already paid.	25.10
recoverable amount	The higher of a non-cash-generating asset's fair value less costs to sell and its value in use.	17.13
	The higher of an asset's or a cash-generating unit's fair value less costs to sell and its value in use.	26.13
recoverable service amount	The higher of a non-cash-generating asset's fair value less costs to sell and its value in use.	21.14

Term	Definition	Location
related party	Parties are considered to be related if one party has the ability to control the other party or exercise significant influence over the other party in making financial and operating decisions or if the related party entity and another entity are subject to common control. Related parties include: (a) Entities that directly, or indirectly through one or more intermediaries, control, or are controlled by the reporting entity; (b) Associates (see International Public Sector Accounting Standard IPSAS 7 Accounting for Investments in Associates); (c) Individuals owning, directly or indirectly, an interest in the reporting entity that gives them significant influence over the entity, and close members of the family of any such individual; (d) Key management personnel, and close members of the family of key management personnel; and (e) Entities in which a substantial ownership interest is held, directly or indirectly, by any person described in (c) or (d), or over which such a person is able to exercise significant influence.	20.4
related party transaction	A transfer of resources or obligations between related parties, regardless of whether a price is charged. Related party transactions exclude transactions with any other entity that is a related party solely because of its economic dependence on the reporting entity or the government of which it forms part.	20.4

GLOSSARY

Term	Definition	Location
remuneration of key management personnel	Any consideration or benefit derived directly or indirectly by key management personnel from the reporting entity for services provided in their capacity as members of the governing body or otherwise as employees of the reporting entity.	20.4
reporting date	The date of the last day of the reporting period to which the financial statements relate.	2.8, 14.5
residual value	The estimated amount that an entity would currently obtain from disposal of the asset, after deducting the estimated costs of disposal, if the asset were already of the age and in the condition expected at the end of its useful life.	17.13
restrictions on transferred assets	Stipulations that limit or direct the purposes for which a transferred asset may be used, but do not specify that future economic benefits or service potential is required to be returned to the transferor if not deployed as specified.	23.7
restructuring	A program that is planned and controlled by management, and materially changes either: (a) The scope of an entity's activities; or (b) The manner in which those activities are carried out.	19.18
retrospective application	Applying a new accounting policy to transactions, other events and conditions as if that policy had always been applied.	3.7
retrospective restatement	Correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.	3.7

Term	Definition	Location
return on plan assets	The interest, dividends and other revenue derived from the plan assets, together with realized and unrealized gains or losses on the plan assets, less any costs of administering the plan and less any tax payable by the plan itself.	25.10
revenue	The gross inflow of economic benefits or service potential during the reporting period when those inflows result in an increase in net assets/equity, other than increases relating to contributions from owners.	1.7, 2.8, 5.5, 9.11, 18.8
segment	Distinguishable activity or group of activities of an entity for which it is appropriate to separately report financial information for the purpose of evaluating the entity's past performance in achieving its objectives and for making decisions about the future allocation of resources.	18.9
segment accounting policies	Accounting policies adopted for preparing and presenting the financial statements of the consolidated group or entity as well as those accounting policies that relate specifically to segment reporting.	18.27

Term	Definition	Location
segment assets	Operating assets that are employed by a segment in its operating activities and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment assets include: • Receivables, loans, investments or other revenue-producing assets that relate to a segment's segment revenue which includes interest or dividend revenue; • Investments accounted for under the equity method only if the net surplus (deficit) from such investments is included in segment revenue; and • Joint venturer's share of the operating assets of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8, "Interests in Joint Ventures." Segment assets do not include income tax or income tax equivalent assets that are recognised in accordance with accounting standards dealing with tax effect accounting.	18.27
segment expense	Expense resulting from the operating activities of a segment that is directly attributable to the segment and the relevant portion of an expense that can be allocated on a reasonable basis to the segment, including expenses relating to the provision of goods and services to external parties and expenses relating to transactions with other segments of the same entity. Segment expense does not include:	

Term	Definition	Location
	(a) Extraordinary items; (b) Interest, including interest incurred on advances or loans from other segments, unless the segment's operations are primarily of a financial nature; (c) Losses on sales of investments or losses on extinguishment of debt unless the segment's operations are primarily of a financial nature; (d) An entity's share of net deficit or losses of associates, joint ventures, or other investments accounted for under the equity method; (e) Income tax or income-tax equivalent expense that is recognised in accordance with accounting standards dealing with tax effect accounting; or (f) General administrative expenses, head office expenses, and other expenses that arise at the entity level and relate to the entity as a whole. However, costs are sometimes incurred at the entity level on behalf of a segment. Such costs are segment expenses if they relate to the segment's operating activities and they can be directly attributed or allocated to the segment on a reasonable basis. Segment expenses includes joint venturer's share of the expenses of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8, "Interests in Joint Ventures."	18.27

GLOSSARY

Term	Definition	Location
segment liabilities	Operating liabilities that result from the operating activities of a segment and that either are directly attributable to the segment or can be allocated to the segment on a reasonable basis. Segment liabilities include: • A joint venturer's share of the liabilities of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8, "Interests in Joint Ventures;" and • Related interest-bearing liabilities if a segment's segment expense includes interest expense. Segment liabilities do not include income tax or income tax equivalent liabilities that are recognised in accordance with accounting standards dealing with tax effect accounting.	18.27
segment revenue	Revenue reported in the entity's statement of financial performance that is directly attributable to a segment and the relevant portion of entity revenue that can be allocated on a reasonable basis to a segment, whether from budget appropriations or similar, grants, transfers, fines, fees or sales to external customers or from transactions with other segments of the same entity. Segment revenue does not include: (a) Extraordinary items; (b) Interest or dividend revenue, including interest earned on advances or loans to other segments, unless the segment's operations are primarily of a financial nature; or (c) Gains on sales of investments or gains on extinguishment of debt unless the segment's operations are primarily of a financial nature. Segment revenue includes: an entity's share of net surplus (deficit) of associates, joint	18.27

Term	Definition	Location
	ventures, or other investments accounted for under the equity method only if those items are included in consolidated or total entity revenue; and a joint venturer's share of the revenue of a jointly controlled entity that is accounted for by proportionate consolidation in accordance with IPSAS 8, "Interests in Joint Ventures."	
separate financial statements	Financial statements presented by a controlling entity, an investor in an associate or a venturer in a jointly controlled entity, in which the investments are accounted for on the basis of the direct net assets/equity interest rather than on the basis of the reported results and net assets of the investees.	
short-term employee benefits	Employee benefits (other than termination benefits) which fall due wholly within twelve months after the end of the period in which the employees render the related service.	25.10
significant influence	The power to participate in the financial and operating policy decisions of an activity but is not control or joint control over those policies.	7.7, 8.6
spot exchange rate	The exchange rate for immediate delivery.	4.10
state plans	Plans other than composite social security programs established by legislation which operate as if they are multi-employer plans for all entities in economic categories laid down in legislation.	25.10
stipulations on transferred assets	Terms in laws or regulation, or a binding arrangement, imposed upon the use of a transferred asset by entities external to the reporting entity.	23.7
tax expenditures	Preferential provisions of the tax law that provide certain taxpayers with concessions that are not available to others.	23.7

Term	Definition	Location
taxable event	The event that the government, legislature or other authority has determined will be subject to taxation.	23.7
taxes	Economic benefits or service potential compulsorily paid or payable to public sector entities, in accordance with laws and or regulations, established to provide revenue to the government. Taxes do not include fines or other penalties imposed for breaches of the law	23.7
termination benefits	Employee benefits payable as a result of either: (a) An entity's decision to terminate an employee's employment before the normal retirement date; or (b) An employee's decision to accept voluntary redundancy in exchange for those benefits.	25.10
transfers	Inflows of future economic benefits or service potential from non-exchange transactions, other than taxes.	23.7
unearned finance revenue	The difference between: (a) The gross investment in the lease; and (b) The net investment in the lease.	13.8
unguaranteed residual value	That portion of the residual value of the leased asset, the realization of which by the lessor is not assured or is guaranteed solely by a party related to the lessor.	13.8
useful life (of a lease)	The estimated remaining period, from the beginning of the lease term, without limitation by the lease term, over which the economic benefits or service potential embodied in the asset are expected to be consumed by the entity.	13.8

Term	Definition	Location
useful life (of property, plant and equipment)	Either: (a) The period over which an asset is expected to be available for use by an entity; or (b) The number of production or similar units expected to be obtained from the asset by an entity.	17.13, 21.14
value in use of a cash-generating asset	The present value of the estimated future cash flows expected to be derived from the continuing use of an asset and from its disposal at the end of its useful life	26.13
value in use of a non-cash-generating asset	The present value of the asset's remaining service potential.	21.14
venturer	A party to a joint venture and has joint control over that joint venture.	8.6
vested employee benefits	Employee benefits that are not conditional on future employment.	25.10

Accrual IPSASs on Issue at December 2008

Accrual International Public Sector Accounting Standards on issue as at December 31, 2008 are:

IPSAS 1	"Presentation of Financial Statements" (December 2006)
IPSAS 2	"Cash Flow Statements" (May 2000)
IPSAS 3	"Accounting Policies, Changes in Accounting Estimates and Errors" (December 2006)
IPSAS 4	"The Effects of Changes in Foreign Exchange Rates" (April 2008)
IPSAS 5	"Borrowing Costs" (May 2000)
IPSAS 6	"Consolidated and Separate Financial Statements" (December 2006)
IPSAS 7	"Investments in Associates" (December 2006)
IPSAS 8	"Interests in Joint Ventures" (December 2006)
IPSAS 9	"Revenue from Exchange Transactions" (June 2001)
IPSAS 10	"Financial Reporting in Hyperinflationary Economies" (June 2001)
IPSAS 11	"Construction Contracts" (June 2001)
IPSAS 12	"Inventories" (December 2006)
IPSAS 13	"Leases" (December 2006)
IPSAS 14	"Events after the Reporting Date" (December 2006)
IPSAS 15	"Financial Instruments: Disclosure and Presentation" (December 2001)
IPSAS 16	"Investment Property" (December 2006)
IPSAS 17	"Property, Plant and Equipment" (December 2006)
IPSAS 18	"Segment Reporting" (June 2002)
IPSAS 19	"Provisions, Contingent Liabilities and Contingent Assets" (October 2002)
IPSAS 20	"Related Party Disclosures" (October 2002)
IPSAS 21	"Impairment of Non-Cash-Generating Assets" (December 2004)
IPSAS 22	"Disclosure of Financial Information about the General Government Sector" (December 2006)
IPSAS 23	"Revenue from Non-Exchange Transactions (Taxes and Transfers)" (December 2006)
IPSAS 24	"Presentation of Budget Information in Financial Statements" (December 2006)
IPSAS 25	"Employee Benefits" (February 2008)
IPSAS 26	"Impairment of Cash-Generating Assets" (February 2008)

GUIDELINE 2—APPLICABILITY OF INTERNATIONAL STANDARDS ON AUDITING TO AUDITS OF FINANCIAL STATEMENTS OF GOVERNMENT BUSINESS ENTERPRISES

Introduction

1. The Introduction to the International Public Sector Accounting Standards Board states that International Public Sector Accounting Standards Board (IPSASB) pronouncements are aimed at developing and harmonizing public sector[1] financial reporting, accounting, and auditing practices. The IPSASB will consider and make use of pronouncements issued by the International Auditing and Assurance Board IAASB (formerly known as International Auditing Practices Committee) to the extent they are applicable to the public sector. International Standards on Auditing (ISAs) issued by the IAASB and International Public Sector Guidelines (IPSGs) are not intended to, and do not, override authoritative national standards issued by governments, regulatory or professional accounting bodies.

2. The purpose of this Guideline is to describe the applicability of ISAs to audits of financial statements[2] of government business enterprises.

GUIDELINES

Government Business Enterprises

3. This Guideline is applicable to such government business enterprises as national railroads, energy utilities, and communication services. Government business enterprises are normally required to operate commercially, that is, to make profits or to recoup, through user charges, a substantial proportion of their operating costs. In many countries, the public sector includes business enterprises that are owned or controlled by government. The principal activity of these government business enterprises is similar to that of private sector business enterprises, that is, to sell goods or services to individuals and nongovernment organizations as well as other public sector entities. Additional characteristics which government business enterprises usually possess are set out in IPSG 1, "Financial Reporting by Government Business Enterprises" (paragraphs 5 to 7).

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1 As described in the Introduction to the IPSASB, "the term 'public sector' refers to national governments, regional (e.g., state, provincial, territorial) governments, local (e.g., city, town) governments and related governmental entities (e.g., agencies, boards, commissions and enterprises)."

2 The term "financial statements," as defined in the Preface to Statements of International Accounting Standards, covers balance sheets, income statements or profit and loss accounts, statements of changes in financial position, notes and other statements and explanatory material which are identified as being part of the financial statements.

Requirements for Audits of Financial Statements

4. Government business enterprises prepare financial statements for the use of legislators and government departments, outside investors, employees, lenders, the public and other users. Auditors are often required to express an opinion on such financial statements. IAASB has developed ISAs for auditors to use whenever an independent audit of financial statements is carried out.

5. The audit objectives for auditing and reporting on financial statements of government business enterprises are similar to those for private sector entities. As such, the same standards should apply regardless of the nature of the enterprise. Users of financial statements are entitled to a uniform quality of assurance and would not be well served by the application of differing standards. Therefore, audits of financial statements of government business enterprises should conform, in all material respects, with ISAs.

6. ISAs describe:

    - The basic principles which govern the auditor's professional responsibilities.
    - The qualifications or essential characteristics of auditors (e.g., adequate training, independence, and due care in performing audits of financial statements).
    - The standards and practices for performing audits of financial statements (e.g., adequate planning and supervision, the assessments of inherent and control risks and their impact on substantive procedures, and the process by which the auditor determines the procedures to be performed when carrying out the audit).
    - The form and content of audit reports.

7. Financial statements of government business enterprises may include information that is different from, or in addition to, that contained in the financial statements of business enterprises in the private sector (e.g., comparison of expenditures in the period with limits established by legislation). In such circumstances, appropriate modifications may be required to the nature, timing and extent of audit procedures, and the auditor's report.

8. Some government business enterprises employ resources to achieve a variety of nonfinancial or social objectives in addition to their commercial objectives. While their audited financial statements provide an accounting of their financial position, results of operations and changes in financial position, these financial statements, by themselves, may not adequately report on the results of their non-commercial activities. Auditors may be required to audit and report on information relating to:

- Compliance with legislation and regulatory requirements (including applicable local public sector pronouncements);
- The adequacy of the enterprise's internal control structure; and
- Economy, efficiency, and effectiveness of programs, projects and activities.

This information may either be included in, or may be in addition to, the enterprise's financial statements. The audit of such information may require auditors to perform work that is in addition to that required solely for the purpose of auditing and reporting on the financial statements.

9. Some government business enterprises may include in their annual reports information on performance in terms of achieving objectives as measured by specified financial or other indicators. Auditors may also be required to audit and report on this additional performance information.

10. This Guideline is not specifically designed to apply to the audit of the information set out in paragraphs 7 to 9; however, this Guideline and ISAs may be useful.

11. A Public Sector Perspective (PSP) on the applicability of ISAs to the audit of financial statements of public sector entities other than government business enterprises is included at the end of each ISA. Where no PSP is added the ISA is applicable in all material respects to the public sector.

The application of ISAs in the public sector was previously dealt with in International Public Sector Guideline 3.

SUMMARY OF OTHER DOCUMENTS

The Committee has issued studies, as summarized below. To obtain copies of these documents, please visit the IFAC website at www.ifac.org or contact the IFAC offices.

Study 1

Financial Reporting by National Governments
Issued March 1991

The scope of the Study is to consider:

- Financial reporting by national governments and their major governmental units;
- Financial reports that provide information on government plans, performance and compliance with relevant authorities;
- Information needs of the principal users of government financial reports, with primary emphasis on the needs of external users; and
- The forms of reporting best suited to meeting those information needs.

This Study is of particular interest to senior financial officers in government, politicians, legislative auditors and others who use government financial reports because it addresses the fundamental underpinnings of governmental financial reporting.

Comparative summaries of users, user needs and objectives were prepared. They illustrate that there is concurrence on who users are, what their needs are and, accordingly, the objectives of financial reporting.

The Study develops a logical progression from users and user needs to the objectives of government financial reporting. It provides further context for the discussion of objectives by exploring the governmental environment and the limits of financial reporting.

The Study then discusses financial reporting. Rather than recommending a single, preferred financial reporting model, the Study describes the spectrum of possible bases of accounting and different reporting models (types of reports). It then illustrates their strengths and weaknesses in meeting the objectives of financial reporting. The Study demonstrates that in moving from single displays of cash receipts and disbursements to summary financial reports that account for total economic resources, more of the objectives of financial reporting are met. Sincethose objectives are derived from user needs, more complete and better information will better meet those needs.

The Study recognizes that financial reporting by national governments is influenced by government financial reporting policies and practices which are embedded in the provisions of legislation and legal prescription.

Study 2

Elements of the Financial Statements of National Governments
Issued July 1993

This Study considers the elements (types or classes of financial information) to be reported in financial statements prepared under the different bases of accounting that may be employed by national governments and their major units and the way in which those elements may be defined. It also considers the implications of reporting particular elements, or subsets thereof, for the messages communicated by financial statements and the achievement of the objectives identified in Study 1.

The Study aims to assist in developing the full potential of the accounting models currently employed in individual jurisdictions to communicate financial information to users. That is useful for accountability and decision making purposes.

This Study focuses on reporting the elements in the financial statements prepared for national governments. However, it is acknowledged that aspects of the delivery of goods and services and the achievement of government objectives will in some cases, be best achieved through the display of financial or non-financial information in notes, schedules or statements other than the statement of financial position or statement of financial performance in the financial report.

Study 3

Auditing for Compliance with Authorities—A Public Sector Perspective
Issued October 1994

This Study addresses aspects of the audit for compliance in the public sector which, in many countries, is subject to very different mandates and objectives than in the private sector. In a democratic system of government, accountability to the public and particularly, to its designated representatives, is an overriding aspect of the management of a public sector entity. Public sector entities are usually established by legislation and their operations governed by various authorities derived from legislation. Management of public sector entities is accountable for operating in accordance with the provisions of the relevant laws, regulations and other authorities governing them. Since legislation and other authorities are the primary means by which legislators control the raising and spending of money by the public sector, auditing for compliance with relevant authorities is usually an important and integral part of the audit mandate, or terms of engagement, for most audits of public sector entities. Because of the variety of authorities, their provisions may be conflicting with one another and may be subject to differing interpretations. Also, subordinate authorities may not adhere to the directions or limits prescribed by the enabling legislation. As a result, an assessment of compliance with authority in the public sector requires considerable professional judgment and is of particular importance.

Study 4

Using the Work of Other Auditors—A Public Sector Perspective
Issued October 1994

This Study addresses using the work of other auditors, including both other external and internal auditors, in financial attest and compliance audits. It considers the matters an auditor has to take into consideration when using the work of another auditor and provides a public sector perspective to International Standard on Auditing (ISA) 600, "Using the Work of Another Auditor" and ISA 610, "Considering the Work of Internal Auditing."

The Study considers the principles stated in the ISAs noted above and describes their applicability to the public sector. It also discusses some of the particular issues arising in the public sector when a principal auditor considers using the work of another auditor. The areas discussed deserving special attention are the autonomy of different tiers of government, the differing mandates of Higher Audit Institutions (HAI), and the particular problems surrounding using the work of other auditors in an international context.

Study 5

Definition and Recognition of Assets
Issued August 1995

This Study identifies and describes the variety of views which exist about whether, when and how specific assets should be measured and reported in the public sector. It considers and explores:

- The definition and recognition of assets;
- The effect of different bases of accounting on the definition and recognition of assets; and
- The issues associated with certain types of assets.

The Study acknowledges that the demand for government services has increased. This growth in demand has meant increasing competition for government services, stimulated by education standards, communication and community interest in government actions. Consequently, governments are under pressure to manage their assets efficiently and effectively. Accountability for efficiency and effectiveness of public sector asset management can be shown through better financial reporting. Better reporting provides a basis of understanding by the public, elected decision makers and by management. This, in turn, supports better decision making and asset allocation.

Study 6

Accounting for and Reporting Liabilities
Issued August 1995

This Study provides a public sector perspective on the definition and recognition of liabilities. It identifies, considers and explores views held on:

- The definition and classification of liabilities;
- The effect of different bases of accounting on accounting for and reporting liabilities; and
- The issues associated with certain types of liabilities.

The Study describes the variety of views which exist about whether, when and how certain liabilities should be measured and reported. Historically, governments have focused on their outstanding debt as a primary measure of the government's liabilities or indebtedness, particularly in formulating or assessing economic policy. However, governments assume a variety of commitments and obligations that give rise to other liabilities that are often unreported by governments. Yet information about all of a government's liabilities and exposure to potential liabilities is vital if governments are to manage their cash flow and make informed decisions about the financing of future services and resource allocation. While governments have liabilities similar to business enterprises, they also have other potential liabilities, such as recurring commitments under established social programs, guarantees and promises made by politicians. The study distinguishes liabilities, commitments and contingencies.

Study 7

Performance Reporting by Government Business Enterprises

Issued January 1996

This Study identifies principal users of performance information, considers the needs of those users, and outlines forms of reporting that could be available to meet those needs. The Study is thereby concerned primarily with the provision of information about an enterprise's performance (covering both financial and non-financial aspects of performance) supplementary to the information provided in financial statements, in the context of general purpose financial statements.

The need for this Study arises from the fact that financial standards on their own are not always sufficient to give an indication of the overall performance of a particular organization. Public sector bodies can differ from private sector enterprises in both their objectives and finance. Although government business enterprises are normally required to operate commercially and usually take the same legal form as private sector business enterprises, the combination of the fact that they often enjoy a monopoly position and the political context in which they operate means that the user of financial reports can rely less on measures of performance such as return on capital employed. As a result, groups with an interest in the performance such as return on capital employed. As a result, groups with an interest in the performance of government business enterprises—governments, legislators, taxpayers and consumers—may have difficulty in making informed judgments about the efficiency and effectiveness of government business enterprises.

Government business enterprises may not be delivering services in circumstances that are even close to being a competitive market. So the test of relative market efficiency and effectiveness cannot always be applied. The issue therefore is how to formulate performance measures that will enable judgments about efficiency and effectiveness to be made. This Study considers how such measures might be defined and how a government business enterprise's performance in relation to these measures might best be reported to those with an interest in its performance.

Study 8

The Government Financial Reporting Entity
Issued July 1996

This Study considers the implications of different approaches to the definition of the government financial reporting entity and different techniques for the construction of government financial reports to the achievement of objectives of financial reports.

This Study is a companion to Study 1, "Financial Reporting by National Governments," issued in March 1991, and Study 2, "Elements of the Financial Statement of National Governments," issued in July 1993. Study 8 builds on the discussions and definitions from Studies 1 and 2. Consistent with Studies 1 and 2, the primary focus of this Study is on financial reporting of national governments. However, the matters it addresses may be equally applicable for other levels of governments (state, provincial and local governments).

It is hoped that this Study will lead to improvements in financial reporting by governments and greater comparability of financial reports both within and between jurisdictions.

Study 9

Definition and Recognition of Revenues
Issued December 1996

This Study examines concepts, principles and issues related to the definitions and recognition of revenues in the general purpose financial statements of national governments and other non-business public sector entities. Specifically, this Study identifies and discusses the definition and classification of revenues, issues with certain types of revenue and the effect of different bases of accounting on the definition and recognition of revenues.

Information on revenues is important in assisting users to assess the financial condition and performance of governments. Comparing revenues with expenses helps users to assess interperiod equity (that is, whether current revenues are sufficient to cover the costs of programs and services provided in the current period).

This Study extends Study 1, "Financial Reporting by National Governments," issued in March 1991, and Study 2, "Elements of the Financial Statement of National Governments," issued in July 1993. It is also a companion to Study 5, "Definition and Recognition of Assets," Study 6, "Accounting for and Reporting Liabilities," and Study 10, "Definition and Recognition of Expenses/Expenditures."

The primary focus of this Study is on the financial statements prepared for national governments and for the entities and units they establish for the delivery of goods and services and the achievement of government objectives. However, the matters it addresses may be equally applicable for other levels of governments (state, provincial and local governments).

Study 10

Definition and Recognition of Expenses/Expenditures
Issued December 1996

This Study examines the concepts, principles and issues related to the treatment of expenses/expenditures in general purpose financial statements of governments and other non-business public sector entities.

Governments are under growing pressures not only to manage their funds effectively, but also to show their management has been effective. To achieve this, governments need complete information about their expenses/expenditures in order to assess their revenue requirements, the sustainability of their programs and their flexibility.

This Study extends Study 1, "Financial Reporting by National Governments," issued in March 1991, and Study 2, "Elements of the Financial Statement of National Governments," issued in July 1993. It is also a companion to Study 5, "Definition and Recognition of Assets," Study 6, "Accounting for and Reporting Liabilities," and Study 9, "Definition and Recognition of Revenues."

The primary focus of this Study is on the financial statements prepared for national governments and for the entities and units they establish for the delivery of goods and services and the achievement of government objectives. However, the matters it addresses may be equally applicable for other levels of governments (state, provincial and local governments).

Study 11

Governmental Financial Reporting: Accounting Issues and Practices
Issued May 2000

This Study aims to assist governments at all levels in the identification of issues associated with financial reporting. Although some parts of the Study may relate to national governments only, other parts are applicable to all levels of government.

The Study contains a detailed description of both accrual and cash bases of accounting and provides examples of actual financial statements prepared under each basis. The document explains common practice within each basis of accounting, and provides examples of the variations within those bases. Governments wishing to change their basis of accounting or modify their accounting policies will be able to use this document as a source of information about a basis of accounting, including accounting policy issues associated with that basis and the format of financial statements prepared under that basis. This may assist governments in changing their basis of accounting and ultimately contribute to greater comparability within and between financial statements of governments.

Study 12

Perspectives on Cost Accounting for Governments
Issued September 2000

This Study intends to aid government financial officers and other government accountants in their efforts to develop and implement cost accounting. It provides government perspectives on cost accounting not available elsewhere, but it is not an in-depth exposition of the subject of cost accounting. The Study includes the following:

- Descriptions of the extent of governmental uses of cost accounting, recent growth, and prospects for future growth.
- Explanations of cost concepts that are relevant to various management objectives.
- Discussions of accounting standards issues where the resolution may affect the values used in the cost accounting exercise.
- Descriptions of how specific concepts and processes might be applied in designing and implementing a cost accounting system.
- Discusses major issues of importance to senior management.

It is designed to help fill the void by providing reference material for governments on this important topic.

Study 13

Governance in the Public Sector: A Governing Body Perspective
Issued July 2001

This Study outlines principles of governance and their application to public sector entities. Governance practices will need to be tailored according to the circumstances of individual public sector entities and the jurisdictions within which they operate. As entities develop and change over time, it will be necessary for the governing body, on an on-going basis, to review and amend governance practices. This Study aims to provide advice by defining common principles and recommendations concerning the governance of public sector entities in certain key areas. Its purpose is to consider an appropriate framework from the perspective of the governing body to assist in ensuring an appropriate balance between freedom to manage, accountability and the legitimate interests of different stakeholders. The Study defines common principles and recommendations concerning the governance of public sector entities with the objective of providing guidance to assist these entities in developing or reviewing their governance practices in such a way to enable them to operate in a more effective, efficient and transparent manner.

Study 14

Transition to the Accrual Basis of Accounting: Guidance for Governments and Government Entities
Issued April 2002, Second Edition Issued December 2003

The Study provides guidance to help government entities intending to move to the accrual basis of accounting and present financial statements which comply with the accrual-based IPSASs.

It is separated into four parts:

Part I addresses general issues associated with the transition to accrual accounting, including factors influencing the nature and speed of the transition, options in respect of the transition paths, and the management of the transition process. It notes the importance of the identification, design and delivery of training programs, and the involvement of the external auditor in the development process. The potential impact of differing systems of government and the existing political environment on the transition process are also discussed.

Part II outlines the steps required to develop and approve accounting policies. It also identifies the types of issues that need to be addressed in identifying controlled entities for the purpose of preparing consolidated financial statements.

Part III considers the classes of assets, liabilities, revenues and expenses that occur in public sector entities. It outlines how these items should be defined, recognized, measured and disclosed in general purposes financial statements. The Study outlines the requirements of key IPSASs and other sources of relevant authoritative guidance, and the types of implementation tasks and issues that arise when complying with these requirements.

Part IV discusses implementation issues arising from a range of specific items, for example, cash, intangible assets, financial instruments, employee-related liabilities, liabilities arising from social policy obligations, non-exchange revenue and foreign currencies.

Summary of main changes to the previous edition of Study 14

IPSASs Published

Subsequent to the publication of the first edition of Study 14 (issued in April 2002), three accrual-based IPSASs and the Cash Basis IPSAS have been issued. Study 14 (2nd edition) has been updated to reflect:

- International Public Sector Accounting Standard (IPSAS) 18, "Segment Reporting;"
- International Public Sector Accounting Standard (IPSAS) 19, "Provisions, Contingent Liabilities and Contingent Assets;"
- International Public Sector Accounting Standard (IPSAS) 20, "Related Party Disclosures;" and
- Cash Basis IPSAS, "Financial Reporting Under The Cash Basis of Accounting."

References and Websites Updated

References and websites have been updated to link with the electronic address of the references used.

Others

The Study has also been updated to reflect other developments including:

- IPSASB has established two steering committees to prepare Invitation to Comment (ITCs) on revenue from non-exchange transactions (including taxes and transfers) and accounting for social policies of governments. Both these ITCs were issued in January 2004; and
- IPSASB has issued an exposure draft on impairment of assets.

Where the IPSASB has not addressed or developed guidance on particular issues, the Study has used examples from IASs. The Study has been updated to reflect recent Exposure Drafts and Standards published by the IASB.

Occasional Paper 1

Implementation of Accrual Accounting in Government: The New Zealand Experience
Issued October 1994

The New Zealand public sector experienced major reform in the late 1980s and early 1990s. This reform changed public sector management from a system based on compliance with detailed and restrictive rules and budget cash limits to a performance and accountability-based regime. The successful implementation of these reforms demanded considerable effort at both strategic and operational levels and led to fundamental and extensive changes in both the management of public sector operations and also in the financial results of those operations. The New Zealand experience demonstrates that such change is not only possible but can also be highly successful.

This paper focuses on the move (migration was the colloquialism) by New Zealand government departments from cash to accrual accounting, and the project to produce the first set of Financial Statements for the New Zealand Government. The paper also attempts to draw out the key management issues in the implementation of full accrual accounting in a national government. The paper is written from the viewpoint of the Treasury which played a central role in the change.

Occasional Paper 2

Auditing Whole of Government Financial Statements: The New Zealand Experience
Issued October 1994

This paper describes the role played by the Audit Office in the development of the Crown financial statements. Following an explanation of the role of the Audit Office in New Zealand, the role played by the Audit Office is analyzed in terms of fundamental audit characteristics such as independence, criteria (in particular, accounting practices to provide a true and fair view in the absence of relevant accounting standards) and evidence. The audit and management processes involved in auditing the Crown financial statements–including planning, setting of materiality levels, project control, training and reporting–are then described. The paper concludes with lessons for other countries.

Occasional Paper 3

Perspectives on Accrual Accounting
Issued 1996

This paper aims to inform readers about a range of perspectives on accrual accounting from a number of contributors who have experience in implementing this accounting reform or who have observed its progress.

The IPSASB believes that by sharing perspectives of those who have been involved in the use of accrual accounting information for decision making purposes, others may gain insights into the value of this form of financial reporting to their own governments and other public sector entities.

The IPSASB deliberately set out to obtain the views of a wide range of people with a range of occupational backgrounds. The IPSASB also set out to focus on people who have experience of changing information outputs. The contributors to this paper are politicians, economists, academics, administrators and accountants.

Occasional Paper 4

The Delegation of Public Services in France: An original Method of Public Administration: Delegated Public Service
Issued September 2001

Government services can be provided in various ways. Usually they are delivered directly by government agencies. In some cases they can be contracted to private sector entities for them to deliver the public service under agreed conditions.

The public service can be said to be “delegated,” Such delegations occur, at the local authority level, in diverse fields such as water distribution, waste management and heating. Delegations are subject to special rules, and are contractual arrangements which balance the interests of the delegating authority and the private enterprise responsible for delivery of the service. Examples of collaborative arrangements of this type exist in other countries (Australia, Canada and New Zealand for example). This Occasional Paper describes the specific framework designed in France to manage the relationship between the parties and to ensure an adequate level of information and accountability.

Occasional Paper 5

Resource Accounting: Framework of Accounting Standard Setting in the UK Central Government Sector
Issued June 2002

The challenges for those moving to the accrual basis can be daunting. It can therefore be helpful for jurisdictions to know something of the issues, both anticipated and unanticipated, which have arisen in jurisdictions adopting the accrual basis and how those issues have been dealt with.

This paper considers the experiences of the United Kingdom, which decided to move to an accrual basis for both budgeting and financial reporting in 1995. It highlights some of the key arguments influencing the decision to adopt an accrual system, not just for financial reporting, but also for budgeting. It also locates accrual based budgeting and reporting in a wider performance management context. It particularly considers how the UK undertook the task of creating the infrastructure for accrual accounting and budgeting in the form of a standard-setting framework and an authoritative manual of accounting policies, principles and treatments.

Occasional Paper 6

The Modernization of Government Accounting in France: The Current Situation, The Issues, The Outlook
Issued January 2003

This paper outlines the process of modernization of the French government accounting system that is currently underway. The paper is organized around three sections:

The current state of public sector accounting practices. This section outlines current practice. It explains that central government, national public establishments, local governments and social security funds do not follow the same accounting and budgetary practices. However, the present reform of central government accounting will lead to the adoption of uniform principles (including faithful representation, and the requirement to present a "true and fair view" of government accounts) and methods (accrual accounting), that French and foreign companies practice every day in their accounting systems.

The transition to accrual accounting: a goal for the near future. This section describes the consequences of the new Constitutional Bylaw 2001 on Budget Acts (known as the new Budgetary Constitution) on the government accounting system. The Budget Acts mandate the very clear distinction between accrual accounting and cash parliamentary appropriation. In France, a dual system will be applied: the national budget (appropriation) is and will continue to be expressed (and executed) on a modified cash basis, whereas the General Account of the Finance Administration (CGAF) (balance sheet and statement of revenue and expenditure) will be expressed on an accrual basis. The CGAFs (*Compte général de l'administration des Finances*) represent the financial statements of the central government.

Action: progress to date and future development. This section traces the progress made in the CGAF presentation since 1999. It outlines a description of the measures undertaken to develop and implement accrual accounting, including the evolution of the information system.

Occasional Paper 7

The Governmental Accounting System in Argentina
Issued January 2004

This Paper provides background to the development of the accounting profession in Argentina and its influence in the public sector. It also provides an overview of the evolution of the public sector accounting system in Argentina from the onset of the Argentine Confederation.

The cash basis of accounting was adopted in the public sector in Argentina in 1859. In 1947, the financial statements were modified to include recognition of expenses on a commitment basis. The Paper outlines the weaknesses in the public sector accounting system which led to subsequent reform of the Governmental Financial Administration and, consequently, the adoption of accrual accounting in 1993.

The Paper outlines challenges and issues that arose in data collection, practice and culture as part of the reform process. It also notes that the reform has brought about a positive impact in Government Financial Administration, including an increase in efficiency and effectiveness in public administration, and delivered more accurate information to support political decision-making.

Finally, the Paper outlines anticipated future developments in the Governmental Accounting System. These include improving management accounting in the public sector to further enhance decision-making, consolidating all public sector entities, creating a continuous training program for public sector employees and harmonizing the Argentine public sector generally accepted accounting principles with International Public Sector Accounting Standards (IPSASs).

Information Paper

The Road to Accrual Accounting in the United States of America
Published March 2006

This information paper considers the experiences of the United States of America in its movement to accrual accounting. It outlines the development of administrative arrangements for formal standards setting over 70 years at the local, state and federal Government levels in the US and highlights key factors shaping the standards setting structure. It also provides a detailed overview of the conversion to accrual accounting by state and local governments, the standards issued by the Government Accounting Standards Board to lead and support that conversion, and identifies key milestones in the conversion process.

ETHICS

CONTENTS

For additional information on the International Ethics Standards Board for Accountants (IESBA), recent developments, and to obtain outstanding exposure drafts, visit the IESBA's page on the IFAC website at http://www.ifac.org/.

June 2005

Revised July 2006

CODE OF ETHICS FOR PROFESSIONAL ACCOUNTANTS[♦]

CONTENTS

♦ The Code was issued in June 2005 and became effective on June 30, 2006. Paragraphs 290.1-290.13 and 290.27-290.47 are applicable to assurance engagements when the assurance report is dated on or after June 30, 2006. Paragraphs 290.14-290.26, which were issued in July 2006, apply to assurance engagements when the assurance report is dated on or after December 31, 2008.

PREFACE

The mission of the International Federation of Accountants (IFAC), as set out in its constitution, is "to serve the public interest, IFAC will continue to strengthen the worldwide accountancy profession and contribute to the development of strong international economies by establishing and promoting adherence to high quality professional standards, furthering the international convergence of such standards and speaking out on public interest issues where the profession's expertise is most relevant." In pursuing this mission, the IFAC Board has established the Ethics Standards Board for Accountants to develop and issue, under its own authority, high quality ethical standards and other pronouncements for professional accountants for use around the world.

This *Code of Ethics for Professional Accountants* establishes ethical requirements for professional accountants. A member body of IFAC or firm may not apply less stringent standards than those stated in this Code. However, if a member body or firm is prohibited from complying with certain parts of this Code by law or regulation, they should comply with all other parts of this Code.

Some jurisdictions may have requirements and guidance that differs from this Code. Professional accountants should be aware of those differences and comply with the more stringent requirements and guidance unless prohibited by law or regulation.

PART A—GENERAL APPLICATION OF THE CODE

SECTION 100

Introduction and Fundamental Principles

100.1 A distinguishing mark of the accountancy profession is its acceptance of the responsibility to act in the public interest. Therefore, a **professional accountant's*** responsibility is not exclusively to satisfy the needs of an individual client or employer. In acting in the public interest a professional accountant should observe and comply with the ethical requirements of this Code.

100.2 This Code is in three parts. Part A establishes the fundamental principles of professional ethics for professional accountants and provides a conceptual framework for applying those principles. The conceptual framework provides guidance on fundamental ethical principles. Professional accountants are required to apply this conceptual framework to identify threats to compliance with the fundamental principles, to evaluate their significance and, if such threats are other than **clearly insignificant*** to apply safeguards to eliminate them or reduce them to an acceptable level such that compliance with the fundamental principles is not compromised.

100.3 Parts B and C illustrate how the conceptual framework is to be applied in specific situations. It provides examples of safeguards that may be appropriate to address threats to compliance with the fundamental principles and also provides examples of situations where safeguards are not available to address the threats and consequently the activity or relationship creating the threats should be avoided. Part B applies to **professional accountants in public practice.*** Part C applies to **professional accountants in business.*** Professional accountants in public practice may also find the guidance in Part C relevant to their particular circumstances.

Fundamental Principles

100.4 A professional accountant is required to comply with the following fundamental principles:

(a) *Integrity*

A professional accountant should be straightforward and honest in all professional and business relationships.

* See Definitions.

(b) *Objectivity*

A professional accountant should not allow bias, conflict of interest or undue influence of others to override professional or business judgments.

(c) *Professional Competence and Due Care*

A professional accountant has a continuing duty to maintain professional knowledge and skill at the level required to ensure that a client or employer receives competent professional service based on current developments in practice, legislation and techniques. A professional accountant should act diligently and in accordance with applicable technical and professional standards when providing **professional services.***

(d) *Confidentiality*

A professional accountant should respect the confidentiality of information acquired as a result of professional and business relationships and should not disclose any such information to third parties without proper and specific authority unless there is a legal or professional right or duty to disclose. Confidential information acquired as a result of professional and business relationships should not be used for the personal advantage of the professional accountant or third parties.

(e) *Professional Behavior*

A professional accountant should comply with relevant laws and regulations and should avoid any action that discredits the profession.

Each of these fundamental principles is discussed in more detail in Sections 110 – 150.

Conceptual Framework Approach

100.5 The circumstances in which professional accountants operate may give rise to specific threats to compliance with the fundamental principles. It is impossible to define every situation that creates such threats and specify the appropriate mitigating action. In addition, the nature of engagements and work assignments may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual framework that requires a professional accountant to identify, evaluate and address threats to compliance with the fundamental principles, rather

* See Definitions.

ETHICS

than merely comply with a set of specific rules which may be arbitrary, is, therefore, in the public interest. This Code provides a framework to assist a professional accountant to identify, evaluate and respond to threats to compliance with the fundamental principles. If identified threats are other than clearly insignificant, a professional accountant should, where appropriate, apply safeguards to eliminate the threats or reduce them to an acceptable level, such that compliance with the fundamental principles is not compromised.

100.6 A professional accountant has an obligation to evaluate any threats to compliance with the fundamental principles when the professional accountant knows, or could reasonably be expected to know, of circumstances or relationships that may compromise compliance with the fundamental principles.

100.7 A professional accountant should take qualitative as well as quantitative factors into account when considering the significance of a threat. If a professional accountant cannot implement appropriate safeguards, the professional accountant should decline or discontinue the specific professional service involved, or where necessary resign from the client (in the case of a professional accountant in public practice) or the employing organization (in the case of a professional accountant in business).

100.8 A professional accountant may inadvertently violate a provision of this Code. Such an inadvertent violation, depending on the nature and significance of the matter, may not compromise compliance with the fundamental principles provided, once the violation is discovered, the violation is corrected promptly and any necessary safeguards are applied.

100.9 Parts B and C of this Code include examples that are intended to illustrate how the conceptual framework is to be applied. The examples are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances experienced by a professional accountant that may create threats to compliance with the fundamental principles. Consequently, it is not sufficient for a professional accountant merely to comply with the examples presented; rather, the framework should be applied to the particular circumstances encountered by the professional accountant.

Threats and Safeguards

100.10 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:

(a) Self-interest threats, which may occur as a result of the financial or other interests of a professional accountant or of an immediate or **close family*** member;

(b) Self-review threats, which may occur when a previous judgment needs to be re-evaluated by the professional accountant responsible for that judgment;

(c) Advocacy threats, which may occur when a professional accountant promotes a position or opinion to the point that subsequent objectivity may be compromised;

(d) Familiarity threats, which may occur when, because of a close relationship, a professional accountant becomes too sympathetic to the interests of others; and

(e) Intimidation threats, which may occur when a professional accountant may be deterred from acting objectively by threats, actual or perceived.

Parts B and C of this Code, respectively, provide examples of circumstances that may create these categories of threats for professional accountants in public practice and professional accountants in business. Professional accountants in public practice may also find the guidance in Part C relevant to their particular circumstances.

100.11 Safeguards that may eliminate or reduce such threats to an acceptable level fall into two broad categories:

(a) Safeguards created by the profession, legislation or regulation; and

(b) Safeguards in the work environment.

100.12 Safeguards created by the profession, legislation or regulation include, but are not restricted to:

- Educational, training and experience requirements for entry into the profession.
- Continuing professional development requirements.
- Corporate governance regulations.
- Professional standards.
- Professional or regulatory monitoring and disciplinary procedures.

* See Definitions.

- External review by a legally empowered third party of the reports, returns, communications or information produced by a professional accountant.

100.13 Parts B and C of this Code, respectively, discuss safeguards in the work environment for professional accountants in public practice and those in business.

100.14 Certain safeguards may increase the likelihood of identifying or deterring unethical behavior. Such safeguards, which may be created by the accounting profession, legislation, regulation or an employing organization, include, but are not restricted to:

- Effective, well publicized complaints systems operated by the employing organization, the profession or a regulator, which enable colleagues, employers and members of the public to draw attention to unprofessional or unethical behavior.
- An explicitly stated duty to report breaches of ethical requirements.

100.15 The nature of the safeguards to be applied will vary depending on the circumstances. In exercising professional judgment, a professional accountant should consider what a reasonable and informed third party, having knowledge of all relevant information, including the significance of the threat and the safeguards applied, would conclude to be unacceptable.

Ethical Conflict Resolution

100.16 In evaluating compliance with the fundamental principles, a professional accountant may be required to resolve a conflict in the application of fundamental principles.

100.17 When initiating either a formal or informal conflict resolution process, a professional accountant should consider the following, either individually or together with others, as part of the resolution process:

(a) Relevant facts;

(b) Ethical issues involved;

(c) Fundamental principles related to the matter in question;

(d) Established internal procedures; and

(e) Alternative courses of action.

Having considered these issues, a professional accountant should determine the appropriate course of action that is consistent with the fundamental principles identified. The professional accountant should also weigh the consequences of each possible course of action. If the matter remains unresolved, the professional accountant should consult with other appropriate persons within the **firm*** or employing organization for help in obtaining resolution.

100.18 Where a matter involves a conflict with, or within, an organization, a professional accountant should also consider consulting with those charged with governance of the organization, such as the board of directors or the audit committee.

100.19 It may be in the best interests of the professional accountant to document the substance of the issue and details of any discussions held or decisions taken, concerning that issue.

100.20 If a significant conflict cannot be resolved, a professional accountant may wish to obtain professional advice from the relevant professional body or legal advisors, and thereby obtain guidance on ethical issues without breaching confidentiality. For example, a professional accountant may have encountered a fraud, the reporting of which could breach the professional accountant's responsibility to respect confidentiality. The professional accountant should consider obtaining legal advice to determine whether there is a requirement to report.

100.21 If, after exhausting all relevant possibilities, the ethical conflict remains unresolved, a professional accountant should, where possible, refuse to remain associated with the matter creating the conflict. The professional accountant may determine that, in the circumstances, it is appropriate to withdraw from the **engagement team*** or specific assignment, or to resign altogether from the engagement, the firm or the employing organization.

* See Definitions.

SECTION 110

Integrity

110.1 The principle of integrity imposes an obligation on all professional accountants to be straightforward and honest in professional and business relationships. Integrity also implies fair dealing and truthfulness.

110.2 A professional accountant should not be associated with reports, returns, communications or other information where they believe that the information:

(a) Contains a materially false or misleading statement;

(b) Contains statements or information furnished recklessly; or

(c) Omits or obscures information required to be included where such omission or obscurity would be misleading.

110.3 A professional accountant will not be considered to be in breach of paragraph 110.2 if the professional accountant provides a modified report in respect of a matter contained in paragraph 110.2.

SECTION 120

Objectivity

120.1 The principle of objectivity imposes an obligation on all professional accountants not to compromise their professional or business judgment because of bias, conflict of interest or the undue influence of others.

120.2 A professional accountant may be exposed to situations that may impair objectivity. It is impracticable to define and prescribe all such situations. Relationships that bias or unduly influence the professional judgment of the professional accountant should be avoided.

SECTION 130

Professional Competence and Due Care

130.1 The principle of professional competence and due care imposes the following obligations on professional accountants:

(a) To maintain professional knowledge and skill at the level required to ensure that clients or employers receive competent professional service; and

(b) To act diligently in accordance with applicable technical and professional standards when providing professional services.

130.2 Competent professional service requires the exercise of sound judgment in applying professional knowledge and skill in the performance of such service. Professional competence may be divided into two separate phases:

(a) Attainment of professional competence; and

(b) Maintenance of professional competence.

130.3 The maintenance of professional competence requires a continuing awareness and an understanding of relevant technical professional and business developments. Continuing professional development develops and maintains the capabilities that enable a professional accountant to perform competently within the professional environments.

130.4 Diligence encompasses the responsibility to act in accordance with the requirements of an assignment, carefully, thoroughly and on a timely basis.

130.5 A professional accountant should take steps to ensure that those working under the professional accountant's authority in a professional capacity have appropriate training and supervision.

130.6 Where appropriate, a professional accountant should make clients, employers or other users of the professional services aware of limitations inherent in the services to avoid the misinterpretation of an expression of opinion as an assertion of fact.

SECTION 140

Confidentiality

140.1 The principle of confidentiality imposes an obligation on professional accountants to refrain from:

(a) Disclosing outside the firm or employing organization confidential information acquired as a result of professional and business relationships without proper and specific authority or unless there is a legal or professional right or duty to disclose; and

(b) Using confidential information acquired as a result of professional and business relationships to their personal advantage or the advantage of third parties.

140.2 A professional accountant should maintain confidentiality even in a social environment. The professional accountant should be alert to the possibility of inadvertent disclosure, particularly in circumstances involving long association with a business associate or a close or **immediate family**[*] member.

140.3 A professional accountant should also maintain confidentiality of information disclosed by a prospective client or employer.

140.4 A professional accountant should also consider the need to maintain confidentiality of information within the firm or employing organization.

140.5 A professional accountant should take all reasonable steps to ensure that staff under the professional accountant's control and persons from whom advice and assistance is obtained respect the professional accountant's duty of confidentiality.

140.6 The need to comply with the principle of confidentiality continues even after the end of relationships between a professional accountant and a client or employer. When a professional accountant changes employment or acquires a new client, the professional accountant is entitled to use prior experience. The professional accountant should not, however, use or disclose any confidential information either acquired or received as a result of a professional or business relationship.

140.7 The following are circumstances where professional accountants are or may be required to disclose confidential information or when such disclosure may be appropriate:

(a) Disclosure is permitted by law and is authorized by the client or the employer;

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[*] See Definitions.

(b) Disclosure is required by law, for example:

   (i) Production of documents or other provision of evidence in the course of legal proceedings; or

   (ii) Disclosure to the appropriate public authorities of infringements of the law that come to light; and

(c) There is a professional duty or right to disclose, when not prohibited by law:

   (i) To comply with the quality review of a member body or professional body;

   (ii) To respond to an inquiry or investigation by a member body or regulatory body;

   (iii) To protect the professional interests of a professional accountant in legal proceedings; or

   (iv) To comply with technical standards and ethics requirements.

140.8 In deciding whether to disclose confidential information, professional accountants should consider the following points:

(a) Whether the interests of all parties, including third parties whose interests may be affected, could be harmed if the client or employer consents to the disclosure of information by the professional accountant;

(b) Whether all the relevant information is known and substantiated, to the extent it is practicable; when the situation involves unsubstantiated facts, incomplete information or unsubstantiated conclusions, professional judgment should be used in determining the type of disclosure to be made, if any; and

(c) The type of communication that is expected and to whom it is addressed; in particular, professional accountants should be satisfied that the parties to whom the communication is addressed are appropriate recipients.

SECTION 150

Professional Behavior

150.1 The principle of professional behavior imposes an obligation on professional accountants to comply with relevant laws and regulations and avoid any action that may bring discredit to the profession. This includes actions which a reasonable and informed third party, having knowledge of all relevant information, would conclude negatively affects the good reputation of the profession.

150.2 In marketing and promoting themselves and their work, professional accountants should not bring the profession into disrepute. Professional accountants should be honest and truthful and should not:

(a) Make exaggerated claims for the services they are able to offer, the qualifications they possess, or experience they have gained; or

(b) Make disparaging references or unsubstantiated comparisons to the work of others.

PART B—PROFESSIONAL ACCOUNTANTS IN PUBLIC PRACTICE

SECTION 200

Introduction

200.1 This Part of the Code illustrates how the conceptual framework contained in Part A is to be applied by professional accountants in public practice. The examples in the following sections are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances experienced by a professional accountant in public practice that may create threats to compliance with the principles. Consequently, it is not sufficient for a professional accountant in public practice merely to comply with the examples presented; rather, the framework should be applied to the particular circumstances faced.

200.2 A professional accountant in public practice should not engage in any business, occupation or activity that impairs or might impair integrity, objectivity or the good reputation of the profession and as a result would be incompatible with the rendering of professional services.

ETHICS

Threats and Safeguards

200.3 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:

(a) Self-interest;

(b) Self-review;

(c) Advocacy;

(d) Familiarity; and

(e) Intimidation.

These threats are discussed further in Part A of this Code.

The nature and significance of the threats may differ depending on whether they arise in relation to the provision of services to a **financial statement audit client**,* a non-financial statement audit **assurance client*** or a non-assurance client.

200.4 Examples of circumstances that may create self-interest threats for a professional accountant in public practice include, but are not limited to:

- A **financial interest*** in a client or jointly holding a financial interest with a client.
- Undue dependence on total fees from a client.

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* See Definitions.

- Having a close business relationship with a client.
- Concern about the possibility of losing a client.
- Potential employment with a client.
- **Contingent fees*** relating to an **assurance engagement**.*
- A loan to or from an assurance client or any of its directors or officers.

200.5 Examples of circumstances that may create self-review threats include, but are not limited to:

- The discovery of a significant error during a re-evaluation of the work of the professional accountant in public practice.
- Reporting on the operation of financial systems after being involved in their design or implementation.
- Having prepared the original data used to generate records that are the subject matter of the engagement.
- A member of the **assurance team*** being, or having recently been, a **director or officer*** of that client.
- A member of the assurance team being, or having recently been, employed by the client in a position to exert direct and significant influence over the subject matter of the engagement.
- Performing a service for a client that directly affects the subject matter of the assurance engagement.

200.6 Examples of circumstances that may create advocacy threats include, but are not limited to:

- Promoting shares in a **listed entity*** when that entity is a financial statement audit client.
- Acting as an advocate on behalf of an assurance client in litigation or disputes with third parties.

200.7 Examples of circumstances that may create familiarity threats include, but are not limited to:

- A member of the engagement team having a close or immediate family relationship with a director or officer of the client.
- A member of the engagement team having a close or immediate family relationship with an employee of the client who is in a

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* See Definitions.

position to exert direct and significant influence over the subject matter of the engagement.

- A former partner of the firm being a director or officer of the client or an employee in a position to exert direct and significant influence over the subject matter of the engagement.
- Accepting gifts or preferential treatment from a client, unless the value is clearly insignificant.
- Long association of senior personnel with the assurance client.

200.8 Examples of circumstances that may create intimidation threats include, but are not limited to:

- Being threatened with dismissal or replacement in relation to a client engagement.
- Being threatened with litigation.
- Being pressured to reduce inappropriately the extent of work performed in order to reduce fees.

200.9 A professional accountant in public practice may also find that specific circumstances give rise to unique threats to compliance with one or more of the fundamental principles. Such unique threats obviously cannot be categorized. In either professional or business relationships, a professional accountant in public practice should always be on the alert for such circumstances and threats.

ETHICS

200.10 Safeguards that may eliminate or reduce threats to an acceptable level fall into two broad categories:

(a) Safeguards created by the profession, legislation or regulation; and

(b) Safeguards in the work environment.

Examples of safeguards created by the profession, legislation or regulation are described in paragraph 100.12 of Part A of this Code.

200.11 In the work environment, the relevant safeguards will vary depending on the circumstances. Work environment safeguards comprise firm-wide safeguards and engagement specific safeguards. A professional accountant in public practice should exercise judgment to determine how to best deal with an identified threat. In exercising this judgment a professional accountant in public practice should consider what a reasonable and informed third party, having knowledge of all relevant information, including the significance of the threat and the safeguards applied, would reasonably conclude to be acceptable. This consideration will be affected by matters such as the significance of the threat, the nature of the engagement and the structure of the firm.

200.12 Firm-wide safeguards in the work environment may include:

- Leadership of the firm that stresses the importance of compliance with the fundamental principles.
- Leadership of the firm that establishes the expectation that members of an assurance team will act in the public interest.
- Policies and procedures to implement and monitor quality control of engagements.
- Documented policies regarding the identification of threats to compliance with the fundamental principles, the evaluation of the significance of these threats and the identification and the application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level.
- For firms that perform assurance engagements, documented **independence*** policies regarding the identification of threats to independence, the evaluation of the significance of these threats and the evaluation and application of safeguards to eliminate or reduce the threats, other than those that are clearly insignificant, to an acceptable level.
- Documented internal policies and procedures requiring compliance with the fundamental principles.
- Policies and procedures that will enable the identification of interests or relationships between the firm or members of engagement teams and clients.
- Policies and procedures to monitor and, if necessary, manage the reliance on revenue received from a single client.
- Using different partners and engagement teams with separate reporting lines for the provision of non-assurance services to an assurance client.
- Policies and procedures to prohibit individuals who are not members of an engagement team from inappropriately influencing the outcome of the engagement.
- Timely communication of a firm’s policies and procedures, including any changes to them, to all partners and professional staff, and appropriate training and education on such policies and procedures.

* See Definitions.

- Designating a member of senior management to be responsible for overseeing the adequate functioning of the firm's quality control system.
- Advising partners and professional staff of those assurance clients and related entities from which they must be independent.
- A disciplinary mechanism to promote compliance with policies and procedures.
- Published policies and procedures to encourage and empower staff to communicate to senior levels within the firm any issue relating to compliance with the fundamental principles that concerns them.

200.13 Engagement-specific safeguards in the work environment may include:

- Involving an additional professional accountant to review the work done or otherwise advise as necessary.
- Consulting an independent third party, such as a committee of independent directors, a professional regulatory body or another professional accountant.
- Discussing ethical issues with those charged with governance of the client.
- Disclosing to those charged with governance of the client the nature of services provided and extent of fees charged.
- Involving another firm to perform or re-perform part of the engagement.
- Rotating senior assurance team personnel.

200.14 Depending on the nature of the engagement, a professional accountant in public practice may also be able to rely on safeguards that the client has implemented. However it is not possible to rely solely on such safeguards to reduce threats to an acceptable level.

200.15 Safeguards within the client's systems and procedures may include:

- When a client appoints a firm in public practice to perform an engagement, persons other than management ratify or approve the appointment.
- The client has competent employees with experience and seniority to make managerial decisions.
- The client has implemented internal procedures that ensure objective choices in commissioning non-assurance engagements.

- The client has a corporate governance structure that provides appropriate oversight and communications regarding the firm's services.

SECTION 210

Professional Appointment

Client Acceptance

210.1 Before accepting a new client relationship, a professional accountant in public practice should consider whether acceptance would create any threats to compliance with the fundamental principles. Potential threats to integrity or professional behavior may be created from, for example, questionable issues associated with the client (its owners, management and activities).

210.2 Client issues that, if known, could threaten compliance with the fundamental principles include, for example, client involvement in illegal activities (such as money laundering), dishonesty or questionable financial reporting practices.

210.3 The significance of any threats should be evaluated. If identified threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.

210.4 Appropriate safeguards may include obtaining knowledge and understanding of the client, its owners, managers and those responsible for its governance and business activities, or securing the client's commitment to improve corporate governance practices or internal controls.

210.5 Where it is not possible to reduce the threats to an acceptable level, a professional accountant in public practice should decline to enter into the client relationship.

210.6 Acceptance decisions should be periodically reviewed for recurring client engagements.

Engagement Acceptance

210.7 A professional accountant in public practice should agree to provide only those services that the professional accountant in public practice is competent to perform. Before accepting a specific client engagement, a professional accountant in public practice should consider whether acceptance would create any threats to compliance with the fundamental principles. For example, a self-interest threat to professional competence and due care is created if the engagement team does not possess, or cannot acquire, the competencies necessary to properly carry out the engagement.

210.8 A professional accountant in public practice should evaluate the significance of identified threats and, if they are other than clearly insignificant, safeguards should be applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include:

- Acquiring an appropriate understanding of the nature of the client's business, the complexity of its operations, the specific requirements of the engagement and the purpose, nature and scope of the work to be performed.
- Acquiring knowledge of relevant industries or subject matters.
- Possessing or obtaining experience with relevant regulatory or reporting requirements.
- Assigning sufficient staff with the necessary competencies.
- Using experts where necessary.
- Agreeing on a realistic time frame for the performance of the engagement.
- Complying with quality control policies and procedures designed to provide reasonable assurance that specific engagements are accepted only when they can be performed competently.

210.9 When a professional accountant in public practice intends to rely on the advice or work of an expert, the professional accountant in public practice should evaluate whether such reliance is warranted. The professional accountant in public practice should consider factors such as reputation, expertise, resources available and applicable professional and ethical standards. Such information may be gained from prior association with the expert or from consulting others.

Changes in a Professional Appointment

210.10 A professional accountant in public practice who is asked to replace another professional accountant in public practice, or who is considering tendering for an engagement currently held by another professional accountant in public practice, should determine whether there are any reasons, professional or other, for not accepting the engagement, such as circumstances that threaten compliance with the fundamental principles. For example, there may be a threat to professional competence and due care if a professional accountant in public practice accepts the engagement before knowing all the pertinent facts.

210.11 The significance of the threats should be evaluated. Depending on the nature of the engagement, this may require direct communication with the **existing accountant**[*] to establish the facts and circumstances behind the

[*] See Definitions.

proposed change so that the professional accountant in public practice can decide whether it would be appropriate to accept the engagement. For example, the apparent reasons for the change in appointment may not fully reflect the facts and may indicate disagreements with the existing accountant that may influence the decision as to whether to accept the appointment.

210.12 An existing accountant is bound by confidentiality. The extent to which the professional accountant in public practice can and should discuss the affairs of a client with a proposed accountant will depend on the nature of the engagement and on:

(a) Whether the client's permission to do so has been obtained; or

(b) The legal or ethical requirements relating to such communications and disclosure, which may vary by jurisdiction.

210.13 In the absence of specific instructions by the client, an existing accountant should not ordinarily volunteer information about the client's affairs. Circumstances where it may be appropriate to disclose confidential information are set out in Section 140 of Part A of this Code.

210.14 If identified threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.

210.15 Such safeguards may include:

- Discussing the client's affairs fully and freely with the existing accountant.
- Asking the existing accountant to provide known information on any facts or circumstances that, in the existing accountant's opinion, the proposed accountant should be aware of before deciding whether to accept the engagement.
- When replying to requests to submit tenders, stating in the tender that, before accepting the engagement, contact with the existing accountant will be requested so that inquiries may be made as to whether there are any professional or other reasons why the appointment should not be accepted.

210.16 A professional accountant in public practice will ordinarily need to obtain the client's permission, preferably in writing, to initiate discussion with an existing accountant. Once that permission is obtained, the existing accountant should comply with relevant legal and other regulations governing such requests. Where the existing accountant provides information, it should be provided honestly and unambiguously. If the proposed accountant is unable to communicate with the existing accountant, the proposed accountant should try to obtain information about any possible threats by other means such as through inquiries of third parties or background investigations on senior management or those charged with governance of the client.

210.17 Where the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in public practice should, unless there is satisfaction as to necessary facts by other means, decline the engagement.

210.18 A professional accountant in public practice may be asked to undertake work that is complementary or additional to the work of the existing accountant. Such circumstances may give rise to potential threats to professional competence and due care resulting from, for example, a lack of or incomplete information. Safeguards against such threats include notifying the existing accountant of the proposed work, which would give the existing accountant the opportunity to provide any relevant information needed for the proper conduct of the work.

SECTION 220

Conflicts of Interest

220.1 A professional accountant in public practice should take reasonable steps to identify circumstances that could pose a conflict of interest. Such circumstances may give rise to threats to compliance with the fundamental principles. For example, a threat to objectivity may be created when a professional accountant in public practice competes directly with a client or has a joint venture or similar arrangement with a major competitor of a client. A threat to objectivity or confidentiality may also be created when a professional accountant in public practice performs services for clients whose interests are in conflict or the clients are in dispute with each other in relation to the matter or transaction in question.

220.2 A professional accountant in public practice should evaluate the significance of any threats. Evaluation includes considering, before accepting or continuing a client relationship or specific engagement, whether the professional accountant in public practice has any business interests, or relationships with the client or a third party that could give rise to threats. If threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level.

220.3 Depending upon the circumstances giving rise to the conflict, safeguards should ordinarily include the professional accountant in public practice:

(a) Notifying the client of the firm’s business interest or activities that may represent a conflict of interest, and obtaining their consent to act in such circumstances; or

(b) Notifying all known relevant parties that the professional accountant in public practice is acting for two or more parties in respect of a matter where their respective interests are in conflict, and obtaining their consent to so act; or

(c) Notifying the client that the professional accountant in public practice does not act exclusively for any one client in the provision of proposed services (for example, in a particular market sector or with respect to a specific service) and obtaining their consent to so act.

220.4 The following additional safeguards should also be considered:

(a) The use of separate engagement teams; and

(b) Procedures to prevent access to information (e.g., strict physical separation of such teams, confidential and secure data filing); and

(c) Clear guidelines for members of the engagement team on issues of security and confidentiality; and

(d) The use of confidentiality agreements signed by employees and partners of the firm; and

(e) Regular review of the application of safeguards by a senior individual not involved with relevant client engagements.

220.5 Where a conflict of interest poses a threat to one or more of the fundamental principles, including objectivity, confidentiality or professional behavior, that cannot be eliminated or reduced to an acceptable level through the application of safeguards, the professional accountant in public practice should conclude that it is not appropriate to accept a specific engagement or that resignation from one or more conflicting engagements is required.

220.6 Where a professional accountant in public practice has requested consent from a client to act for another party (which may or may not be an existing client) in respect of a matter where the respective interests are in conflict and that consent has been refused by the client, then the professional accountant in public practice must not continue to act for one of the parties in the matter giving rise to the conflict of interest.

SECTION 230

Second Opinions

230.1 Situations where a professional accountant in public practice is asked to provide a second opinion on the application of accounting, auditing, reporting or other standards or principles to specific circumstances or transactions by or on behalf of a company or an entity that is not an existing client may give rise to threats to compliance with the fundamental principles. For example, there may be a threat to professional competence and due care in circumstances where the second opinion is not based on the same set of facts that were made available to the existing accountant, or is based on inadequate evidence. The significance of the threat will depend on the circumstances of the request and all the other available facts and assumptions relevant to the expression of a professional judgment.

230.2 When asked to provide such an opinion, a professional accountant in public practice should evaluate the significance of the threats and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include seeking client permission to contact the existing accountant, describing the limitations surrounding any opinion in communications with the client and providing the existing accountant with a copy of the opinion.

230.3 If the company or entity seeking the opinion will not permit communication with the existing accountant, a professional accountant in public practice should consider whether, taking all the circumstances into account, it is appropriate to provide the opinion sought.

SECTION 240

Fees and Other Types of Remuneration

240.1 When entering into negotiations regarding professional services, a professional accountant in public practice may quote whatever fee deemed to be appropriate. The fact that one professional accountant in public practice may quote a fee lower than another is not in itself unethical. Nevertheless, there may be threats to compliance with the fundamental principles arising from the level of fees quoted. For example, a self-interest threat to professional competence and due care is created if the fee quoted is so low that it may be difficult to perform the engagement in accordance with applicable technical and professional standards for that price.

240.2 The significance of such threats will depend on factors such as the level of fee quoted and the services to which it applies. In view of these potential threats, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Safeguards which may be adopted include:

- Making the client aware of the terms of the engagement and, in particular, the basis on which fees are charged and which services are covered by the quoted fee.
- Assigning appropriate time and qualified staff to the task.

240.3 Contingent fees are widely used for certain types of non-assurance engagements.[1] They may, however, give rise to threats to compliance with the fundamental principles in certain circumstances. They may give rise to a self-interest threat to objectivity. The significance of such threats will depend on factors including:

- The nature of the engagement.
- The range of possible fee amounts.
- The basis for determining the fee.
- Whether the outcome or result of the transaction is to be reviewed by an independent third party.

240.4 The significance of such threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate or reduce them to an acceptable level. Such safeguards may include:

[1] Contingent fees for non-assurance services provided to assurance clients are discussed in Section 290 of this part of the Code.

- An advance written agreement with the client as to the basis of remuneration.
- Disclosure to intended users of the work performed by the professional accountant in public practice and the basis of remuneration.
- Quality control policies and procedures.
- Review by an objective third party of the work performed by the professional accountant in public practice.

240.5 In certain circumstances, a professional accountant in public practice may receive a referral fee or commission relating to a client. For example, where the professional accountant in public practice does not provide the specific service required, a fee may be received for referring a continuing client to another professional accountant in public practice or other expert. A professional accountant in public practice may receive a commission from a third party (e.g., a software vendor) in connection with the sale of goods or services to a client. Accepting such a referral fee or commission may give rise to self-interest threats to objectivity and professional competence and due care.

240.6 A professional accountant in public practice may also pay a referral fee to obtain a client, for example, where the client continues as a client of another professional accountant in public practice but requires specialist services not offered by the existing accountant. The payment of such a referral fee may also create a self-interest threat to objectivity and professional competence and due care.

240.7 A professional accountant in public practice should not pay or receive a referral fee or commission, unless the professional accountant in public practice has established safeguards to eliminate the threats or reduce them to an acceptable level. Such safeguards may include:

- Disclosing to the client any arrangements to pay a referral fee to another professional accountant for the work referred.
- Disclosing to the client any arrangements to receive a referral fee for referring the client to another professional accountant in public practice.
- Obtaining advance agreement from the client for commission arrangements in connection with the sale by a third party of goods or services to the client.

240.8 A professional accountant in public practice may purchase all or part of another firm on the basis that payments will be made to individuals formerly owning the firm or to their heirs or estates. Such payments are not regarded as commissions or referral fees for the purpose of paragraph 240.5–240.7 above.

SECTION 250

Marketing Professional Services

250.1 When a professional accountant in public practice solicits new work through **advertising**[*] or other forms of marketing, there may be potential threats to compliance with the fundamental principles. For example, a self-interest threat to compliance with the principle of professional behavior is created if services, achievements or products are marketed in a way that is inconsistent with that principle.

250.2 A professional accountant in public practice should not bring the profession into disrepute when marketing professional services. The professional accountant in public practice should be honest and truthful and should not:

- Make exaggerated claims for services offered, qualifications possessed or experience gained; or
- Make disparaging references to unsubstantiated comparisons to the work of another.

If the professional accountant in public practice is in doubt whether a proposed form of advertising or marketing is appropriate, the professional accountant in public practice should consult with the relevant professional body.

ETHICS

[*] See Definitions.

SECTION 260

Gifts and Hospitality

260.1 A professional accountant in public practice, or an immediate or close family member, may be offered gifts and hospitality from a client. Such an offer ordinarily gives rise to threats to compliance with the fundamental principles. For example, self-interest threats to objectivity may be created if a gift from a client is accepted; intimidation threats to objectivity may result from the possibility of such offers being made public.

260.2 The significance of such threats will depend on the nature, value and intent behind the offer. Where gifts or hospitality which a reasonable and informed third party, having knowledge of all relevant information, would consider clearly insignificant are made a professional accountant in public practice may conclude that the offer is made in the normal course of business without the specific intent to influence decision making or to obtain information. In such cases, the professional accountant in public practice may generally conclude that there is no significant threat to compliance with the fundamental principles.

260.3 If evaluated threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in public practice should not accept such an offer.

SECTION 270

Custody of Client Assets

270.1 A professional accountant in public practice should not assume custody of client monies or other assets unless permitted to do so by law and, if so, in compliance with any additional legal duties imposed on a professional accountant in public practice holding such assets.

270.2 The holding of client assets creates threats to compliance with the fundamental principles; for example, there is a self-interest threat to professional behavior and may be a self interest threat to objectivity arising from holding client assets. To safeguard against such threats, a professional accountant in public practice entrusted with money (or other assets) belonging to others should:

(a) Keep such assets separately from personal or firm assets; and

(b) Use such assets only for the purpose for which they are intended; and

(c) At all times, be ready to account for those assets, and any income, dividends or gains generated, to any persons entitled to such accounting; and

(d) Comply with all relevant laws and regulations relevant to the holding of and accounting for such assets.

270.3 In addition, professional accountants in public practice should be aware of threats to compliance with the fundamental principles through association with such assets, for example, if the assets were found to derive from illegal activities, such as money laundering. As part of client and engagement acceptance procedures for such services, professional accountants in public practice should make appropriate inquiries about the source of such assets and should consider their legal and regulatory obligations. They may also consider seeking legal advice.

SECTION 280

Objectivity—All Services

280.1 A professional accountant in public practice should consider when providing any professional service whether there are threats to compliance with the fundamental principle of objectivity resulting from having interests in, or relationships with, a client or directors, officers or employees. For example, a familiarity threat to objectivity may be created from a family or close personal or business relationship.

280.2 A professional accountant in public practice who provides an assurance service is required to be independent of the assurance client. Independence of mind and in appearance is necessary to enable the professional accountant in public practice to express a conclusion, and be seen to express a conclusion, without bias, conflict of interest or undue influence of others. Section 290 provides specific guidance on independence requirements for professional accountants in public practice when performing an assurance engagement.

280.3 The existence of threats to objectivity when providing any professional service will depend upon the particular circumstances of the engagement and the nature of the work that the professional accountant in public practice is performing.

280.4 A professional accountant in public practice should evaluate the significance of identified threats and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include:

- Withdrawing from the engagement team.
- Supervisory procedures.
- Terminating the financial or business relationship giving rise to the threat.
- Discussing the issue with higher levels of management within the firm.
- Discussing the issue with those charged with governance of the client.

SECTION 290

Independence—Assurance Engagements

290.1 In the case of an assurance engagement it is in the public interest and, therefore, required by this Code of Ethics, that members of **assurance teams**,* firms and, when applicable, **network firms*** be independent of assurance clients.

290.2 Assurance engagements are designed to enhance intended users' degree of confidence about the outcome of the evaluation or measurement of a subject matter against criteria. The International Framework for Assurance Engagements (the Assurance Framework) issued by the International Auditing and Assurance Standards Board describes the elements and objectives of an assurance engagement, and identifies engagements to which International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs) and International Standards on Assurance Engagements (ISAEs) apply. For a description of the elements and objectives of an assurance engagement reference should be made to the Assurance Framework.

290.3 As further explained in the Assurance Framework, in an assurance engagement the professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

290.4 The outcome of the evaluation or measurement of a subject matter is the information that results from applying the criteria to the subject matter. The term "subject matter information" is used to mean the outcome of the evaluation or measurement of subject matter. For example:

- The recognition, measurement, presentation and disclosure represented in the **financial statements*** (subject matter information) result from applying a financial reporting framework for recognition, measurement, presentation and disclosure, such as International Financial Reporting Standards, (criteria) to an entity's financial position, financial performance and cash flows (subject matter).
- An assertion about the effectiveness of internal control (subject matter information) results from applying a framework for evaluating the effectiveness of internal control, such as COSO or CoCo, (criteria) to internal control, a process (subject matter).

ETHICS

* See Definitions.

290.5 Assurance engagements may be assertion-based or direct reporting. In either case they involve three separate parties: a public accountant in public practice, a responsible party and intended users.

290.6 In an assertion-based assurance engagement, which includes a **financial statement audit engagement**,* the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users.

290.7 In a direct reporting assurance engagement the professional accountant in public practice either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report.

290.8 Independence requires:

Independence of Mind

The state of mind that permits the expression of a conclusion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

Independence in Appearance

The avoidance of facts and circumstances that are so significant that a reasonable and informed third party, having knowledge of all relevant information, including safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

290.9 The use of the word "independence" on its own may create misunderstandings. Standing alone, the word may lead observers to suppose that a person exercising professional judgment ought to be free from all economic, financial and other relationships. This is impossible, as every member of society has relationships with others. Therefore, the significance of economic, financial and other relationships should also be evaluated in the light of what a reasonable and informed third party having knowledge of all relevant information would reasonably conclude to be unacceptable.

290.10 Many different circumstances, or combination of circumstances, may be relevant and accordingly it is impossible to define every situation that creates threats to independence and specify the appropriate mitigating

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* See Definitions.

action that should be taken. In addition, the nature of assurance engagements may differ and consequently different threats may exist, requiring the application of different safeguards. A conceptual framework that requires firms and members of assurance teams to identify, evaluate and address threats to independence, rather than merely comply with a set of specific rules which may be arbitrary, is, therefore, in the public interest.

A Conceptual Approach to Independence

290.11 Members of assurance teams, firms and network firms are required to apply the conceptual framework contained in Section 100 to the particular circumstances under consideration. In addition to identifying relationships between the firm, network firms, members of the assurance team and the assurance client, consideration should be given to whether relationships between individuals outside of the assurance team and the assurance client create threats to independence.

290.12 The examples presented in this section are intended to illustrate the application of the conceptual framework and are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances that may create threats to independence. Consequently, it is not sufficient for a member of an assurance team, a firm or a network firm merely to comply with the examples presented, rather they should apply the framework to the particular circumstances they face.

290.13 The nature of the threats to independence and the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level differ depending on the characteristics of the individual assurance engagement: whether it is a financial statement audit engagement or another type of assurance engagement; and in the latter case, the purpose, subject matter information and intended users of the report. A firm should, therefore, evaluate the relevant circumstances, the nature of the assurance engagement and the threats to independence in deciding whether it is appropriate to accept or continue an engagement, as well as the nature of the safeguards required and whether a particular individual should be a member of the assurance team.

Networks and Network Firms[2]

290.14 An entity that belongs to a network might be a firm, which is defined in this Code as a sole practitioner, partnership or corporation of professional accountants and an entity that controls or is controlled by such parties, or the entity might be another type of entity, such as a consulting practice or a

2 Paragraphs 290.14-290.26, which were issued in July 2006, apply to assurance engagements when the assurance report is dated on or after December 31, 2008.

professional law practice. The independence requirements in this section that apply to a network firm apply to any entity that meets the definition of a network firm irrespective of whether the entity itself meets the definition of a firm.

290.15 If a firm is considered to be a network firm, the firm is required to be independent of the financial statement audit clients of the other firms within the network. In addition, for assurance clients that are not financial statement audit clients, consideration should be given to any threats the firm has reason to believe may be created by financial interests in the client held by other entities in the network or by relationships between the client and other entities in the network.

290.16 To enhance their ability to provide professional services, firms frequently form larger structures with other firms and entities. Whether these larger structures create a network depends upon the particular facts and circumstances and does not depend on whether the firms and entities are legally separate and distinct. For example, a larger structure may be aimed only at facilitating the referral of work, which in itself does not meet the criteria necessary to constitute a network. Alternatively, a larger structure might be such that it is aimed at co-operation and the firms share a common brand name, a common system of quality control, or significant professional resources and consequently is considered to be a network.

290.17 The judgment as to whether the larger structure is a network should be made in light of whether a reasonable and informed third party would be likely to conclude, weighing all the specific facts and circumstances, that the entities are associated in such a way that a network exists. This judgment should be applied consistently throughout the network.

290.18 Where the larger structure is aimed at co-operation and it is clearly aimed at profit or cost sharing among the entities within the structure, it is considered to be a network. However, the sharing of immaterial costs would not in itself create a network. In addition, if the sharing of costs is limited only to those costs related to the development of audit methodologies, manuals, or training courses, this would not in itself create a network. Further, an association between a firm and an otherwise unrelated entity to jointly provide a service or develop a product would not in itself create a network.

290.19 Where the larger structure is aimed at cooperation and the entities within the structure share common ownership, control or management, it is considered to be a network. This could be achieved by contract or other means.

290.20 Where the larger structure is aimed at co-operation and the entities within the structure share common quality control policies and procedures, it is considered to be a network. For this purpose common quality control policies and procedures would be those designed, implemented and monitored across the larger structure.

290.21 Where the larger structure is aimed at co-operation and the entities within the structure share a common business strategy, it is considered to be a network. Sharing a common business strategy involves an agreement by the entities to achieve common strategic objectives. An entity is not considered to be a network firm merely because it co-operates with another entity solely to respond jointly to a request for a proposal for the provision of a professional service.

290.22 Where the larger structure is aimed at co-operation and the entities within the structure share the use of a common brand name, it is considered to be a network. A common brand name includes common initials or a common name. A firm is considered to be using a common brand name if it includes, for example, the common brand name as part of, or along with, its firm name, when a partner of the firm signs an assurance report.

290.23 Even though a firm does not belong to a network and does not use a common brand name as part of its firm name, it may give the appearance that it belongs to a network if it makes reference in its stationery or promotional materials to being a member of an association of firms. Accordingly, a firm should carefully consider how it describes any such memberships in order to avoid the perception that it belongs to a network.

290.24 If a firm sells a component of its practice, the sales agreement sometimes provides that, for a limited period of time, the component may continue to use the name of the firm, or an element of the name, even though it is no longer connected to the firm. In such circumstances, while the two entities may be practicing under a common name, the facts are such that they do not belong to a larger structure aimed at co-operation and are, therefore, not network firms. Those entities should carefully consider how to disclose that they are not network firms when presenting themselves to outside parties.

290.25 Where the larger structure is aimed at co-operation and the entities within the structure share a significant part of professional resources, it is considered to be a network. Professional resources include:

- Common systems that enable firms to exchange information such as client data, billing, and time records;
- Partners and staff;
- Technical departments to consult on technical or industry specific issues, transactions or events for assurance engagements;
- Audit methodology or audit manuals; and
- Training courses and facilities.

290.26 The determination of whether the professional resources shared are significant, and therefore the firms are network firms, should be made based on the relevant facts and circumstances. Where the shared resources are limited to common audit methodology or audit manuals, with no exchange of personnel or client or market information, it is unlikely that the shared resources would be considered to be significant. The same applies to a common training endeavor. Where, however, the shared resources involve the exchange of people or information, such as where staff are drawn from a shared pool, or a common technical department is created within the larger structure to provide participating firms with technical advice that the firms are required to follow, a reasonable and informed third party is more likely to conclude that the shared resources are significant.

Assertion-Based Assurance Engagements

Financial Statement Audit Engagements

290.27 Financial statement audit engagements are relevant to a wide range of potential users; consequently, in addition to independence of mind, independence in appearance is of particular significance. Accordingly, for financial statement audit clients, the members of the assurance team, the firm and network firms are required to be independent of the financial statement audit client. Such independence requirements include prohibitions regarding certain relationships between members of the assurance team and directors, officers and employees of the client in a position to exert direct and significant influence over the subject matter information (the financial statements). Also, consideration should be given to whether threats to independence are created by relationships with employees of the client in a position to exert direct and significant influence over the subject matter (the financial position, financial performance and cash flows).

Other Assertion-Based Assurance Engagements

290.28 In an assertion-based assurance engagement where the client is not a financial statement audit client, the members of the assurance team and the firm are required to be independent of the assurance client (the responsible party, which is responsible for the subject matter information and may be responsible for the subject matter). Such independence requirements include prohibitions regarding certain relationships between members of the assurance team and directors, officers and employees of the client in a position to exert direct and significant influence over the subject matter information. Also, consideration should be given to whether threats to independence are created by relationships with employees of the client in a position to exert direct and significant influence over the subject matter of the engagement. Consideration should also be given to any threats that the firm has reason to believe may be created by network firm interests and relationships.

290.29 In the majority of assertion-based assurance engagements, that are not financial statement audit engagements, the responsible party is responsible for the subject matter information and the subject matter. However, in some engagements the responsible party may not be responsible for the subject matter. For example, when a professional accountant in public practice is engaged to perform an assurance engagement regarding a report that an environmental consultant has prepared about a company's sustainability practices, for distribution to intended users, the environmental consultant is the responsible party for the subject matter information but the company is responsible for the subject matter (the sustainability practices).

290.30 In those assertion-based assurance engagements that are not financial statement audit engagements, where the responsible party is responsible for the subject matter information but not the subject matter the members of the assurance team and the firm are required to be independent of the party responsible for the subject matter information (the assurance client). In addition, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.

Direct Reporting Assurance Engagements

290.31 In a direct reporting assurance engagement the members of the assurance team and the firm are required to be independent of the assurance client (the party responsible for the subject matter).

Restricted Use Reports

290.32 In the case of an assurance report in respect of a non-financial statement audit client expressly restricted for use by identified users, the users of the report are considered to be knowledgeable as to the purpose, subject matter information and limitations of the report through their participation in establishing the nature and scope of the firm's instructions to deliver the services, including the criteria against which the subject matter are to be evaluated or measured. This knowledge and the enhanced ability of the firm to communicate about safeguards with all users of the report increase the effectiveness of safeguards to independence in appearance. These circumstances may be taken into account by the firm in evaluating the threats to independence and considering the applicable safeguards necessary to eliminate the threats or reduce them to an acceptable level. At a minimum, it will be necessary to apply the provisions of this section in evaluating the independence of members of the assurance team and their immediate and close family. Further, if the firm had a material financial interest, whether direct or indirect, in the assurance client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Limited consideration of any threats created by network firm interests and relationships may be sufficient.

Multiple Responsible Parties

290.33 In some assurance engagements, whether assertion-based or direct reporting, that are not financial statement audit engagements, there might be several responsible parties. In such engagements, in determining whether it is necessary to apply the provisions in this section to each responsible party, the firm may take into account whether an interest or relationship between the firm, or a member of the assurance team, and a particular responsible party would create a threat to independence that is other than clearly insignificant in the context of the subject matter information. This will take into account factors such as:

- The materiality of the subject matter information (or the subject matter) for which the particular responsible party is responsible; and
- The degree of public interest associated with the engagement.

If the firm determines that the threat to independence created by any such interest or relationship with a particular responsible party would be clearly insignificant it may not be necessary to apply all of the provisions of this section to that responsible party.

Other Considerations

290.34 The threats and safeguards identified in this section are generally discussed in the context of interests or relationships between the firm, network firms, members of the assurance team and the assurance client. In the case of a financial statement audit client that is a listed entity, the firm and any network firms are required to consider the interests and relationships that involve that client's related entities. Ideally those entities and the interests and relationships should be identified in advance. For all other assurance clients, when the assurance team has reason to believe that a **related entity*** of such an assurance client is relevant to the evaluation of the firm's independence of the client, the assurance team should consider that related entity when evaluating independence and applying appropriate safeguards.

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* See Definitions.

290.35 The evaluation of threats to independence and subsequent action should be supported by evidence obtained before accepting the engagement and while it is being performed. The obligation to make such an evaluation and take action arises when a firm, a network firm or a member of the assurance team knows, or could reasonably be expected to know, of circumstances or relationships that might compromise independence. There may be occasions when the firm, a network firm or an individual inadvertently violates this section. If such an inadvertent violation occurs, it would generally not compromise independence with respect to an assurance client provided the firm has appropriate quality control policies and procedures in place to promote independence and, once discovered, the violation is corrected promptly and any necessary safeguards are applied.

290.36 Throughout this section, reference is made to significant and clearly insignificant threats in the evaluation of independence. In considering the significance of any particular matter, qualitative as well as quantitative factors should be taken into account. A matter should be considered clearly insignificant only if it is deemed to be both trivial and inconsequential.

Objective and Structure of this Section

290.37 The objective of this section is to assist firms and members of assurance teams in:

(a) Identifying threats to independence;

(b) Evaluating whether these threats are clearly insignificant; and

(c) In cases when the threats are not clearly insignificant, identifying and applying appropriate safeguards to eliminate or reduce the threats to an acceptable level.

Consideration should always be given to what a reasonable and informed third party having knowledge of all relevant information, including safeguards applied, would reasonably conclude to be unacceptable. In situations when no safeguards are available to reduce the threat to an acceptable level, the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement.

290.38 This section concludes with some examples of how this conceptual approach to independence is to be applied to specific circumstances and relationships. The examples discuss threats to independence that may be created by specific circumstances and relationships (paragraphs 290.100 onwards). Professional judgment is used to determine the appropriate safeguards to eliminate threats to independence or to reduce them to an acceptable level. In certain examples, the threats to independence are so significant the only possible actions are to eliminate the activities or interest creating the threat, or to refuse to accept or continue the assurance engagement. In other examples, the threat can be eliminated or reduced to an acceptable level by the application of safeguards. The examples are not intended to be all-inclusive.

290.39 Certain examples in this section indicate how the framework is to be applied to a financial statements audit engagement for a listed entity. When a member body chooses not to differentiate between listed entities and other entities, the examples that relate to financial statement audit engagements for listed entities should be considered to apply to all financial statement audit engagements.

290.40 When threats to independence that are not clearly insignificant are identified, and the firm decides to accept or continue the assurance engagement, the decision should be documented. The documentation should include a description of the threats identified and the safeguards applied to eliminate or reduce the threats to an acceptable level.

290.41 The evaluation of the significance of any threats to independence and the safeguards necessary to reduce any threats to an acceptable level, takes into account the public interest. Certain entities may be of significant public interest because, as a result of their business, their size or their corporate status they have a wide range of stakeholders. Examples of such entities may include listed companies, credit institutions, insurance companies, and pension funds. Because of the strong public interest in the financial statements of listed entities, certain paragraphs in this section deal with additional matters that are relevant to the financial statement audit of listed entities. Consideration should be given to the application of the framework in relation to the financial statement audit of listed entities to other financial statement audit clients that may be of significant public interest.

290.42 Audit committees can have an important corporate governance role when they are independent of client management and can assist the Board of Directors in satisfying themselves that a firm is independent in carrying out its audit role. There should be regular communications between the firm and the audit committee (or other governance body if there is no audit committee) of listed entities regarding relationships and other matters that might, in the firm’s opinion, reasonably be thought to bear on independence.

290.43 Firms should establish policies and procedures relating to independence communications with audit committees, or others charged with governance of the client. In the case of the financial statement audit of listed entities, the firm should communicate orally and in writing at least annually, all relationships and other matters between the firm, network firms and the financial statement audit client that in the firm’s professional judgment may reasonably be thought to bear on independence. Matters to be communicated will vary in each circumstance and should be decided by the firm, but should generally address the relevant matters set out in this section.

Engagement Period

290.44 The members of the assurance team and the firm should be independent of the assurance client during the period of the assurance engagement. The period of the engagement starts when the assurance team begins to perform assurance services and ends when the assurance report is issued, except when the assurance engagement is of a recurring nature. If the assurance engagement is expected to recur, the period of the assurance engagement ends with the notification by either party that the professional relationship has terminated or the issuance of the final assurance report, whichever is later.

290.45 In the case of a financial statement audit engagement, the engagement period includes the period covered by the financial statements reported on by the firm. When an entity becomes a financial statement audit client during or after the period covered by the financial statements that the firm will report on, the firm should consider whether any threats to independence may be created by:

- Financial or business relationships with the audit client during or after the period covered by the financial statements, but prior to the acceptance of the financial statement audit engagement; or
- Previous services provided to the audit client.

Similarly, in the case of an assurance engagement that is not a financial statement audit engagement, the firm should consider whether any financial or business relationships or previous services may create threats to independence.

290.46 If a non-assurance service was provided to the financial statement audit client during or after the period covered by the financial statements but before the commencement of professional services in connection with the financial statement audit and the service would be prohibited during the period of the audit engagement, consideration should be given to the threats to independence, if any, arising from the service. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards may include:

- Discussing independence issues related to the provision of the non-assurance service with those charged with governance of the client, such as the audit committee;

- Obtaining the client's acknowledgement of responsibility for the results of the non-assurance service;
- Precluding personnel who provided the non-assurance service from participating in the financial statement audit engagement; and
- Engaging another firm to review the results of the non-assurance service or having another firm re-perform the non-assurance service to the extent necessary to enable it to take responsibility for the service.

290.47 A non-assurance service provided to a non-listed financial statement audit client will not impair the firm's independence when the client becomes a listed entity provided:

(a) The previous non-assurance service was permissible under this section for non-listed financial statement audit clients;

(b) The service will be terminated within a reasonable period of time of the client becoming a listed entity, if they are impermissible under this section for financial statement audit clients that are listed entities; and

(c) The firm has implemented appropriate safeguards to eliminate any threats to independence arising from the previous service or reduce them to an acceptable level.

Application of Framework to Specific Situations

Contents **Paragraph**

Introduction

290.100 The following examples describe specific circumstances and relationships that may create threats to independence. The examples describe the potential threats created and the safeguards that may be appropriate to eliminate the threats or reduce them to an acceptable level in each circumstance. The examples are not all inclusive. In practice, the firm, network firms and the members of the assurance team will be required to assess the implications of similar, but different, circumstances and relationships and to determine whether safeguards, including the safeguards in paragraphs 200.12-200.15 can be applied to satisfactorily address the threats to independence.

290.101 Some of the examples deal with financial statement audit clients while others deal with assurance engagements for clients that are not financial statement audit clients. The examples illustrate how safeguards should be applied to fulfill the requirement for the members of the assurance team, the firm and network firms to be independent of a financial statement audit client, and for the members of the assurance team and the firm to be independent of an assurance client that is not a financial statement audit client. The examples do not include assurance reports to a non-financial statement audit client expressly restricted for use by identified users. As stated in paragraph 290.32 for such engagements, members of the assurance team and their immediate and close family are required to be independent of the assurance client. Further, the firm should not have a material financial interest, direct or indirect, in the assurance client.

290.102 The examples illustrate how the framework applies to financial statement audit clients and other assurance clients. The examples should be read in conjunction with paragraph 290.33 which explain that, in the majority of assurance engagements, there is one responsible party and that responsible party comprises the assurance client. However, in some assurance engagements there are two responsible parties. In such circumstances, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.

290.103 Interpretation 2005-01 to this section provides further guidance on the application of the independence requirements contained in this section to assurance engagements that are not financial statement audit engagements.

Financial Interests

290.104 A financial interest in an assurance client may create a self-interest threat. In evaluating the significance of the threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, it is necessary to examine the nature of the financial interest. This includes an evaluation of the role of the person holding the financial interest, the materiality of the financial interest and the type of financial interest (direct or indirect).

290.105 When evaluating the type of financial interest, consideration should be given to the fact that financial interests range from those where the individual has no control over the investment vehicle or the financial interest held (e.g., a mutual fund, unit trust or similar intermediary vehicle) to those where the individual has control over the financial interest (e.g., as a trustee) or is able to influence investment decisions. In evaluating the significance of any threat to independence, it is important to consider the degree of control or influence that can be exercised over the intermediary, the financial interest held, or its investment strategy. When control exists, the financial interest should be considered direct. Conversely, when the holder of the financial interest has no ability to exercise such control the financial interest should be considered indirect.

Provisions Applicable to all Assurance Clients

290.106 If a member of the assurance team, or their immediate family member, has a **direct financial interest**,* or a material **indirect financial interest**,* in the assurance client, the self-interest threat created would be so significant the only safeguards available to eliminate the threat or reduce it to an acceptable level would be to:

(a) Dispose of the direct financial interest prior to the individual becoming a member of the assurance team;

(b) Dispose of the indirect financial interest in total or dispose of a sufficient amount of it so that the remaining interest is no longer material prior to the individual becoming a member of the assurance team; or

(c) Remove the member of the assurance team from the assurance engagement.

290.107 If a member of the assurance team, or their immediate family member receives, by way of, for example, an inheritance, gift or, as a result of a merger, a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat would be created. The following safeguards should be applied to eliminate the threat or reduce it to an acceptable level:

(a) Disposing of the financial interest at the earliest practical date; or

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* See Definitions.

(b) Removing the member of the assurance team from the assurance engagement.

During the period prior to disposal of the financial interest or the removal of the individual from the assurance team, consideration should be given to whether additional safeguards are necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Discussing the matter with those charged with governance, such as the audit committee; or
- Involving an additional professional accountant to review the work done, or otherwise advise as necessary.

290.108 When a member of the assurance team knows that his or her close family member has a direct financial interest or a material indirect financial interest in the assurance client, a self-interest threat may be created. In evaluating the significance of any threat, consideration should be given to the nature of the relationship between the member of the assurance team and the close family member and the materiality of the financial interest. Once the significance of the threat has been evaluated, safeguards should be considered and applied as necessary. Such safeguards might include:

- The close family member disposing of all or a sufficient portion of the financial interest at the earliest practical date;
- Discussing the matter with those charged with governance, such as the audit committee;
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team with the close family relationship or otherwise advise as necessary; or
- Removing the individual from the assurance engagement.

290.109 When a firm or a member of the assurance team holds a direct financial interest or a material indirect financial interest in the assurance client as a trustee, a self-interest threat may be created by the possible influence of the trust over the assurance client. Accordingly, such an interest should only be held when:

(a) The member of the assurance team, an immediate family member of the member of the assurance team, and the firm are not beneficiaries of the trust;

(b) The interest held by the trust in the assurance client is not material to the trust;

(c) The trust is not able to exercise significant influence over the assurance client; and

(d) The member of the assurance team or the firm does not have significant influence over any investment decision involving a financial interest in the assurance client.

290.110 Consideration should be given to whether a self-interest threat may be created by the financial interests of individuals outside of the assurance team and their immediate and close family members. Such individuals would include:

- Partners, and their immediate family members, who are not members of the assurance team;
- Partners and managerial employees who provide non-assurance services to the assurance client; and
- Individuals who have a close personal relationship with a member of the assurance team.

Whether the interests held by such individuals may create a self-interest threat will depend upon factors such as:

- The firm's organizational, operating and reporting structure; and
- The nature of the relationship between the individual and the member of the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Where appropriate, policies to restrict people from holding such interests;
- Discussing the matter with those charged with governance, such as the audit committee; or
- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done or otherwise advise as necessary.

290.111 An inadvertent violation of this section as it relates to a financial interest in an assurance client would not impair the independence of the firm, the network firm or a member of the assurance team when:

(a) The firm, and the network firm, have established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from the purchase, inheritance or other acquisition of a financial interest in the assurance client;

(b) The firm, and the network firm, promptly notify the professional that the financial interest should be disposed of; and

(c) The disposal occurs at the earliest practical date after identification of the issue, or the professional is removed from the assurance team.

290.112 When an inadvertent violation of this section relating to a financial interest in an assurance client has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:

- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or
- Excluding the individual from any substantive decision-making concerning the assurance engagement.

Provisions Applicable to Financial Statement Audit Clients

290.113 If a firm, or a network firm, has a direct financial interest in a financial statement audit client of the firm the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.

290.114 If a firm, or a network firm, has a material indirect financial interest in a financial statement audit client of the firm a self-interest threat is also created. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

290.115 If a firm, or a network firm, has a material financial interest in an entity that has a controlling interest in a financial statement audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only actions appropriate to permit the firm to perform the engagement would be for the firm, or the network firm, either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

290.116 If the retirement benefit plan of a firm, or network firm, has a financial interest in a financial statement audit client a self-interest threat may be created. Accordingly, the significance of any such threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

290.117 If other partners, including partners who do not perform assurance engagements, or their immediate family, in the **office**[*] in which the

engagement partner* practices in connection with the financial statement audit hold a direct financial interest or a material indirect financial interest in that audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such partners or their immediate family should not hold any such financial interests in such an audit client.

290.118 The office in which the engagement partner practices in connection with the financial statement audit is not necessarily the office to which that partner is assigned. Accordingly, when the engagement partner is located in a different office from that of the other members of the assurance team, judgment should be used to determine in which office the partner practices in connection with that audit.

290.119 If other partners and managerial employees who provide non-assurance services to the financial statement audit client, except those whose involvement is clearly insignificant, or their immediate family, hold a direct financial interest or a material indirect financial interest in the audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Accordingly, such personnel or their immediate family should not hold any such financial interests in such an audit client.

290.120 A financial interest in a financial statement audit client that is held by an immediate family member of (a) a partner located in the office in which the engagement partner practices in connection with the audit, or (b) a partner or managerial employee who provides non-assurance services to the audit client is not considered to create an unacceptable threat provided it is received as a result of their employment rights (e.g., pension rights or share options) and, where necessary, appropriate safeguards are applied to reduce any threat to independence to an acceptable level.

290.121 A self-interest threat may be created if the firm, or the network firm, or a member of the assurance team has an interest in an entity and a financial statement audit client, or a director, officer or controlling owner thereof also has an investment in that entity. Independence is not compromised with respect to the audit client if the respective interests of the firm, the network firm, or member of the assurance team, and the audit client, or director, officer or controlling owner thereof are both immaterial and the audit client cannot exercise significant influence over the entity. If an interest is material, to either the firm, the network firm or the audit client, and the audit client can exercise significant influence over the entity, no safeguards are available to reduce the threat to an acceptable level and the firm, or the network firm, should either dispose of the interest or decline

* See Definitions.

the audit engagement. Any member of the assurance team with such a material interest should either:

(a) Dispose of the interest;

(b) Dispose of a sufficient amount of the interest so that the remaining interest is no longer material; or

(c) Withdraw from the audit.

Provisions Applicable to Non-Financial Statement Audit Assurance Clients

290.122 If a firm has a direct financial interest in an assurance client that is not a financial statement audit client the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, disposal of the financial interest would be the only action appropriate to permit the firm to perform the engagement.

290.123 If a firm has a material indirect financial interest in an assurance client that is not a financial statement audit client a self-interest threat is also created. The only action appropriate to permit the firm to perform the engagement would be for the firm to either dispose of the indirect interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

290.124 If a firm has a material financial interest in an entity that has a controlling interest in an assurance client that is not a financial statement audit client, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level. The only action appropriate to permit the firm to perform the engagement would be for the firm either to dispose of the financial interest in total or to dispose of a sufficient amount of it so that the remaining interest is no longer material.

290.125 When a restricted use report for an assurance engagement that is not a financial statement audit engagement is issued, exceptions to the provisions in paragraphs 290.106-290.110 and 290.122-290.124 are set out in 290.32.

Loans and Guarantees

290.126 A loan, or a guarantee of a loan, to the firm from an assurance client that is a bank or a similar institution, would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements and the loan is immaterial to both the firm and the assurance client. If the loan is material to the assurance client or the firm it may be possible, through the application of safeguards, to reduce the self-interest threat created to an acceptable level. Such safeguards might include involving an additional professional accountant from outside the firm, or network firm, to review the work performed.

290.127 A loan, or a guarantee of a loan, from an assurance client that is a bank or a similar institution, to a member of the assurance team or their immediate family would not create a threat to independence provided the loan, or guarantee, is made under normal lending procedures, terms and requirements. Examples of such loans include home mortgages, bank overdrafts, car loans and credit card balances.

290.128 Similarly, deposits made by, or brokerage accounts of, a firm or a member of the assurance team with an assurance client that is a bank, broker or similar institution would not create a threat to independence provided the deposit or account is held under normal commercial terms.

290.129 If the firm, or a member of the assurance team, makes a loan to an assurance client, that is not a bank or similar institution, or guarantees such an assurance client's borrowing, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.

290.130 Similarly, if the firm or a member of the assurance team accepts a loan from, or has borrowing guaranteed by, an assurance client that is not a bank or similar institution, the self-interest threat created would be so significant no safeguard could reduce the threat to an acceptable level, unless the loan or guarantee is immaterial to both the firm or the member of the assurance team and the assurance client.

290.131 The examples in paragraphs 290.126–290.130 relate to loans and guarantees between the firm and an assurance client. In the case of a financial statement audit engagement, the provisions should be applied to the firm, all network firms and the audit client.

Close Business Relationships with Assurance Clients

290.132 A close business relationship between a firm or a member of the assurance team and the assurance client or its management, or between the firm, a network firm and a financial statement audit client, will involve a commercial or common financial interest and may create self-interest and intimidation threats. The following are examples of such relationships:

- Having a material financial interest in a joint venture with the assurance client or a controlling owner, director, officer or other individual who performs senior managerial functions for that client.
- Arrangements to combine one or more services or products of the firm with one or more services or products of the assurance client and to market the package with reference to both parties.

- Distribution or marketing arrangements under which the firm acts as a distributor or marketer of the assurance client's products or services, or the assurance client acts as the distributor or marketer of the products or services of the firm.

In the case of a financial statement audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm, the network firm and the audit client, no safeguards could reduce the threat to an acceptable level. In the case of an assurance client that is not a financial statement audit client, unless the financial interest is immaterial and the relationship is clearly insignificant to the firm and the assurance client, no safeguards could reduce the threat to an acceptable level. Consequently, in both these circumstances the only possible courses of action are to:

(a) Terminate the business relationship;

(b) Reduce the magnitude of the relationship so that the financial interest is immaterial and the relationship is clearly insignificant; or

(c) Refuse to perform the assurance engagement.

Unless any such financial interest is immaterial and the relationship is clearly insignificant to the member of the assurance team, the only appropriate safeguard would be to remove the individual from the assurance team.

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290.133 In the case of a financial statement audit client, business relationships involving an interest held by the firm, a network firm or a member of the assurance team or their immediate family in a closely held entity when the audit client or a director or officer of the audit client, or any group thereof, also has an interest in that entity, do not create threats to independence provided:

(a) The relationship is clearly insignificant to the firm, the network firm and the audit client;

(b) The interest held is immaterial to the investor, or group of investors; and

(c) The interest does not give the investor, or group of investors, the ability to control the closely held entity.

290.134 The purchase of goods and services from an assurance client by the firm (or from a financial statement audit client by a network firm) or a member of the assurance team would not generally create a threat to independence providing the transaction is in the normal course of business and on an arm's length basis. However, such transactions may be of a nature or magnitude so as to create a self-interest threat. If the threat created is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Eliminating or reducing the magnitude of the transaction;
- Removing the individual from the assurance team; or
- Discussing the issue with those charged with governance, such as the audit committee.

Family and Personal Relationships

290.135 Family and personal relationships between a member of the assurance team and a director, an officer or certain employees, depending on their role, of the assurance client, may create self-interest, familiarity or intimidation threats. It is impracticable to attempt to describe in detail the significance of the threats that such relationships may create. The significance will depend upon a number of factors including the individual's responsibilities on the assurance engagement, the closeness of the relationship and the role of the family member or other individual within the assurance client. Consequently, there is a wide spectrum of circumstances that will need to be evaluated and safeguards to be applied to reduce the threat to an acceptable level.

290.136 When an immediate family member of a member of the assurance team is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement, or was in such a position during any period covered by the engagement, the threats to independence can only be reduced to an acceptable level by removing the individual from the assurance team. The closeness of the relationship is such that no other safeguard could reduce the threat to independence to an acceptable level. If application of this safeguard is not used, the only course of action is to withdraw from the assurance engagement. For example, in the case of an audit of financial statements, if the spouse of a member of the assurance team is an employee in a position to exert direct and significant influence over the preparation of the audit client's accounting records or financial statements, the threat to independence could only be reduced to an acceptable level by removing the individual from the assurance team.

290.137 When an immediate family member of a member the assurance team is an employee in a position to exert direct and significant influence over the subject matter of the engagement, threats to independence may be created. The significance of the threats will depend on factors such as:

- The position the immediate family member holds with the client; and

- The role of the professional on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Removing the individual from the assurance team;
- Where possible, structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the immediate family member; or
- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.

290.138 When a close family member of a member of the assurance team is a director, an officer, or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement, threats to independence may be created. The significance of the threats will depend on factors such as:

- The position the close family member holds with the client; and
- The role of the professional on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Removing the individual from the assurance team;
- Where possible, structuring the responsibilities of the assurance team so that the professional does not deal with matters that are within the responsibility of the close family member; or
- Policies and procedures to empower staff to communicate to senior levels within the firm any issue of independence and objectivity that concerns them.

290.139 In addition, self-interest, familiarity or intimidation threats may be created when a person who is other than an immediate or close family member of a member of the assurance team has a close relationship with the member of the assurance team and is a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement. Therefore, members of the assurance team are responsible for identifying any such persons and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship and the role of the individual within the assurance client.

290.140 Consideration should be given to whether self-interest, familiarity or intimidation threats may be created by a personal or family relationship between a partner or employee of the firm who is not a member of the assurance team and a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement. Therefore partners and employees of the firm are responsible for identifying any such relationships and for consulting in accordance with firm procedures. The evaluation of the significance of any threat created and the safeguards appropriate to eliminate the threat or reduce it to an acceptable level will include considering matters such as the closeness of the relationship, the interaction of the firm professional with the assurance team, the position held within the firm, and the role of the individual within the assurance client.

290.141 An inadvertent violation of this section as it relates to family and personal relationships would not impair the independence of a firm or a member of the assurance team when:

(a) The firm has established policies and procedures that require all professionals to report promptly to the firm any breaches resulting from changes in the employment status of their immediate or close family members or other personal relationships that create threats to independence;

(b) Either the responsibilities of the assurance team are re-structured so that the professional does not deal with matters that are within the responsibility of the person with whom he or she is related or has a personal relationship, or, if this is not possible, the firm promptly removes the professional from the assurance engagement; and

(c) Additional care is given to reviewing the work of the professional.

290.142 When an inadvertent violation of this section relating to family and personal relationships has occurred, the firm should consider whether any safeguards should be applied. Such safeguards might include:

- Involving an additional professional accountant who did not take part in the assurance engagement to review the work done by the member of the assurance team; or
- Excluding the individual from any substantive decision-making concerning the assurance engagement.

Employment with Assurance Clients

290.143 A firm or a member of the assurance team's independence may be threatened if a director, an officer or an employee of the assurance client in a position to exert direct and significant influence over the subject matter information of the assurance engagement has been a member of the assurance team or partner of the firm. Such circumstances may create self-interest, familiarity and intimidation threats particularly when significant connections remain between the individual and his or her former firm. Similarly, a member of the assurance team's independence may be threatened when an individual participates in the assurance engagement knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future.

290.144 If a member of the assurance team, partner or former partner of the firm has joined the assurance client, the significance of the self-interest, familiarity or intimidation threats created will depend upon the following factors:

(a) The position the individual has taken at the assurance client.

(b) The amount of any involvement the individual will have with the assurance team.

(c) The length of time that has passed since the individual was a member of the assurance team or firm.

(d) The former position of the individual within the assurance team or firm.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Considering the appropriateness or necessity of modifying the assurance plan for the assurance engagement;
- Assigning an assurance team to the subsequent assurance engagement that is of sufficient experience in relation to the individual who has joined the assurance client;
- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary; or
- Quality control review of the assurance engagement.

In all cases, all of the following safeguards are necessary to reduce the threat to an acceptable level:

(a) The individual concerned is not entitled to any benefits or payments from the firm unless these are made in accordance with fixed pre-determined arrangements. In addition, any amount owed to the individual should not be of such significance to threaten the firm's independence.

(b) The individual does not continue to participate or appear to participate in the firm's business or professional activities.

290.145 A self-interest threat is created when a member of the assurance team participates in the assurance engagement while knowing, or having reason to believe, that he or she is to, or may, join the assurance client some time in the future. This threat can be reduced to an acceptable level by the application of all of the following safeguards:

(a) Policies and procedures to require the individual to notify the firm when entering serious employment negotiations with the assurance client.

(b) Removal of the individual from the assurance engagement.

In addition, consideration should be given to performing an independent review of any significant judgments made by that individual while on the engagement.

Recent Service with Assurance Clients

290.146 To have a former officer, director or employee of the assurance client serve as a member of the assurance team may create self-interest, self-review and familiarity threats. This would be particularly true when a member of the assurance team has to report on, for example, subject matter information he or she had prepared or elements of the financial statements he or she had valued while with the assurance client.

290.147 If, during the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement, the threat created would be so significant no safeguard could reduce the threat to an acceptable level. Consequently, such individuals should not be assigned to the assurance team.

290.148 If, prior to the period covered by the assurance report, a member of the assurance team had served as an officer or director of the assurance client, or had been an employee in a position to exert direct and significant influence over the subject matter information of the assurance engagement, this may create self-interest, self-review and familiarity threats. For example, such threats would be created if a decision made or work performed by the individual in the prior period, while employed by the assurance client, is to be evaluated in the current period as part of the current assurance engagement. The significance of the threats will depend upon factors such as:

- The position the individual held with the assurance client;
- The length of time that has passed since the individual left the assurance client; and
- The role the individual plays on the assurance team.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Involving an additional professional accountant to review the work done by the individual as part of the assurance team or otherwise advise as necessary; or
- Discussing the issue with those charged with governance, such as the audit committee.

Serving as an Officer or Director on the Board of Assurance Clients

290.149 If a partner or employee of the firm serves as an officer or as a director on the board of an assurance client the self-review and self-interest threats created would be so significant no safeguard could reduce the threats to an acceptable level. In the case of a financial statement audit engagement, if a partner or employee of a network firm were to serve as an officer or as a director on the board of the audit client the threats created would be so significant no safeguard could reduce the threats to an acceptable level. Consequently, if such an individual were to accept such a position the only course of action is to refuse to perform, or to withdraw from the assurance engagement.

290.150 The position of Company Secretary has different implications in different jurisdictions. The duties may range from administrative duties such as personnel management and the maintenance of company records and registers, to duties as diverse as ensuring that the company complies with regulations or providing advice on corporate governance matters. Generally this position is seen to imply a close degree of association with the entity and may create self-review and advocacy threats.

290.151 If a partner or employee of the firm or a network firm serves as Company Secretary for a financial statement audit client the self-review and advocacy threats created would generally be so significant, no safeguard could reduce the threat to an acceptable level. When the practice is specifically permitted under local law, professional rules or practice, the duties and functions undertaken should be limited to those of a routine and formal administrative nature such as the preparation of minutes and maintenance of statutory returns.

290.152 Routine administrative services to support a company secretarial function or advisory work in relation to company secretarial administration matters is generally not perceived to impair independence, provided client management makes all relevant decisions.

Long Association of Senior Personnel with Assurance Clients

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290.153 Using the same senior personnel on an assurance engagement over a long period of time may create a familiarity threat. The significance of the threat will depend upon factors such as:

- The length of time that the individual has been a member of the assurance team;
- The role of the individual on the assurance team;
- The structure of the firm; and
- The nature of the assurance engagement.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied to reduce the threat to an acceptable level. Such safeguards might include:

- Rotating the senior personnel off the assurance team;
- Involving an additional professional accountant who was not a member of the assurance team to review the work done by the senior personnel or otherwise advise as necessary; or
- Independent internal quality reviews.

Financial Statement Audit Clients that are Listed Entities[3]

290.154 Using the same engagement partner or the same individual responsible for the **engagement quality control review**[*] on a financial statement audit over a prolonged period may create a familiarity threat. This threat is particularly relevant in the context of the financial statement audit of a listed entity and safeguards should be applied in such situations to reduce such threat to an acceptable level. Accordingly in respect of the financial statement audit of listed entities:

[3] See also Interpretation 2003-01 on page 98.

[*] See Definitions.

(a) The engagement partner and the individual responsible for the engagement quality control review should be rotated after serving in either capacity, or a combination thereof, for a pre-defined period, normally no more than seven years; and

(b) Such an individual rotating after a pre-defined period should not participate in the audit engagement until a further period of time, normally two years, has elapsed.

290.155 When a financial statement audit client becomes a listed entity the length of time the engagement partner or the individual responsible for the engagement quality control review has served the audit client in that capacity should be considered in determining when the individual should be rotated. However, the person may continue to serve as the engagement partner or as the individual responsible for the engagement quality control review for two additional years before rotating off the engagement.

290.156 While the engagement partner and the individual responsible for the engagement quality control review should be rotated after such a pre-defined period, some degree of flexibility over timing of rotation may be necessary in certain circumstances. Examples of such circumstances include:

- Situations when the person's continuity is especially important to the financial statement audit client, for example, when there will be major changes to the audit client's structure that would otherwise coincide with the rotation of the person's; and
- Situations when, due to the size of the firm, rotation is not possible or does not constitute an appropriate safeguard.

In all such circumstances when the person is not rotated after such a pre-defined period equivalent safeguards should be applied to reduce any threats to an acceptable level.

290.157 When a firm has only a few people with the necessary knowledge and experience to serve as engagement partner or individual responsible for the engagement quality control review on a financial statement audit client that is a listed entity, rotation may not be an appropriate safeguard. In these circumstances the firm should apply other safeguards to reduce the threat to an acceptable level. Such safeguards would include involving an additional professional accountant who was not otherwise associated with the assurance team to review the work done or otherwise advise as necessary. This individual could be someone from outside the firm or someone within the firm who was not otherwise associated with the assurance team.

Provision of Non-Assurance Services to Assurance Clients[4]

290.158 Firms have traditionally provided to their assurance clients a range of non-assurance services that are consistent with their skills and expertise. Assurance clients value the benefits that derive from having these firms, which have a good understanding of the business, bring their knowledge and skill to bear in other areas. Furthermore, the provision of such non-assurance services will often result in the assurance team obtaining information regarding the assurance client's business and operations that is helpful in relation to the assurance engagement. The greater the knowledge of the assurance client's business, the better the assurance team will understand the assurance client's procedures and controls, and the business and financial risks that it faces. The provision of non-assurance services may, however, create threats to the independence of the firm, a network firm or the members of the assurance team, particularly with respect to perceived threats to independence. Consequently, it is necessary to evaluate the significance of any threat created by the provision of such services. In some cases it may be possible to eliminate or reduce the threat created by application of safeguards. In other cases no safeguards are available to reduce the threat to an acceptable level.

290.159 The following activities would generally create self-interest or self-review threats that are so significant that only avoidance of the activity or refusal to perform the assurance engagement would reduce the threats to an acceptable level:

- Authorizing, executing or consummating a transaction, or otherwise exercising authority on behalf of the assurance client, or having the authority to do so.
- Determining which recommendation of the firm should be implemented.
- Reporting, in a management role, to those charged with governance.

290.160 The examples set out in paragraphs 290.166–290.205 are addressed in the context of the provision of non-assurance services to an assurance client. The potential threats to independence will most frequently arise when a non-assurance service is provided to a financial statement audit client. The financial statements of an entity provide financial information about a broad range of transactions and events that have affected the entity. The subject matter information of other assurance services, however, may be limited in nature. Threats to independence, however, may also arise when a firm provides a non-assurance service related to the subject matter

4 See also Interpretation 2003-02 on page 98.

information, of a non-financial statement audit assurance engagement. In such cases, consideration should be given to the significance of the firm's involvement with the subject matter information, of the engagement, whether any self-review threats are created and whether any threats to independence could be reduced to an acceptable level by application of safeguards, or whether the engagement should be declined. When the non-assurance service is not related to the subject matter information, of the non-financial statement audit assurance engagement, the threats to independence will generally be clearly insignificant.

290.161 The following activities may also create self-review or self-interest threats:

- Having custody of an assurance client's assets.
- Supervising assurance client employees in the performance of their normal recurring activities.
- Preparing source documents or originating data, in electronic or other form, evidencing the occurrence of a transaction (for example, purchase orders, payroll time records, and customer orders).

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Making arrangements so that personnel providing such services do not participate in the assurance engagement;
- Involving an additional professional accountant to advise on the potential impact of the activities on the independence of the firm and the assurance team; or
- Other relevant safeguards set out in national regulations.

290.162 New developments in business, the evolution of financial markets, rapid changes in information technology, and the consequences for management and control, make it impossible to draw up an all-inclusive list of all situations when providing non-assurance services to an assurance client might create threats to independence and of the different safeguards that might eliminate these threats or reduce them to an acceptable level. In general, however, a firm may provide services beyond the assurance engagement provided any threats to independence have been reduced to an acceptable level.

290.163 The following safeguards may be particularly relevant in reducing to an acceptable level threats created by the provision of non-assurance services to assurance clients:

- Policies and procedures to prohibit professional staff from making management decisions for the assurance client, or assuming responsibility for such decisions.
- Discussing independence issues related to the provision of non-assurance services with those charged with governance, such as the audit committee.
- Policies within the assurance client regarding the oversight responsibility for provision of non-assurance services by the firm.
- Involving an additional professional accountant to advise on the potential impact of the non-assurance engagement on the independence of the member of the assurance team and the firm.
- Involving an additional professional accountant outside of the firm to provide assurance on a discrete aspect of the assurance engagement.
- Obtaining the assurance client's acknowledgement of responsibility for the results of the work performed by the firm.
- Disclosing to those charged with governance, such as the audit committee, the nature and extent of fees charged.
- Making arrangements so that personnel providing non-assurance services do not participate in the assurance engagement.

290.164 Before the firm accepts an engagement to provide a non-assurance service to an assurance client, consideration should be given to whether the provision of such a service would create a threat to independence. In situations when a threat created is other than clearly insignificant, the non-assurance engagement should be declined unless appropriate safeguards can be applied to eliminate the threat or reduce it to an acceptable level.

290.165 The provision of certain non-assurance services to financial statement audit clients may create threats to independence so significant that no safeguard could eliminate the threat or reduce it to an acceptable level. However, the provision of such services to a related entity, division or discrete financial statement item of such clients may be permissible when any threats to the firm's independence have been reduced to an acceptable level by arrangements for that related entity, division or discrete financial statement item to be audited by another firm or when another firm re-performs the non-assurance service to the extent necessary to enable it to take responsibility for that service.

Preparing Accounting Records and Financial Statements

290.166 Assisting a financial statement audit client in matters such as preparing accounting records or financial statements may create a self-review threat when the financial statements are subsequently audited by the firm.

290.167 It is the responsibility of financial statement audit client management to ensure that accounting records are kept and financial statements are prepared, although they may request the firm to provide assistance. If firm, or network firm, personnel providing such assistance make management decisions, the self-review threat created could not be reduced to an acceptable level by any safeguards. Consequently, personnel should not make such decisions. Examples of such managerial decisions include:

- Determining or changing journal entries, or the classifications for accounts or transaction or other accounting records without obtaining the approval of the financial statement audit client;
- Authorizing or approving transactions; and
- Preparing source documents or originating data (including decisions on valuation assumptions), or making changes to such documents or data.

290.168 The audit process involves extensive dialogue between the firm and management of the financial statement audit client. During this process, management requests and receives significant input regarding such matters as accounting principles and financial statement disclosure, the appropriateness of controls and the methods used in determining the stated amounts of assets and liabilities. Technical assistance of this nature and advice on accounting principles for financial statement audit clients are an appropriate means to promote the fair presentation of the financial statements. The provision of such advice does not generally threaten the firm’s independence. Similarly, the financial statement audit process may involve assisting an audit client in resolving account reconciliation problems, analyzing and accumulating information for regulatory reporting, assisting in the preparation of consolidated financial statements (including the translation of local statutory accounts to comply with group accounting policies and the transition to a different reporting framework such as International Financial Reporting Standards), drafting disclosure items, proposing adjusting journal entries and providing assistance and advice in the preparation of local statutory accounts of subsidiary entities. These services are considered to be a normal part of the audit process and do not, under normal circumstances, threaten independence.

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290.169 The examples in paragraphs 290.170–290.173 indicate that self-review threats may be created if the firm is involved in the preparation of accounting records or financial statements and those financial statements are subsequently the subject matter information of an audit engagement of the firm. This notion may be equally applicable in situations when the subject matter information of the assurance engagement is not financial statements. For example, a self-review threat would be created if the firm developed and prepared prospective financial information and subsequently provided assurance on this prospective financial information. Consequently, the firm should evaluate the significance of any self-review threat created by the provision of such services. If the self-review threat is other than clearly insignificant safeguards should be considered and applied as necessary to reduce the threat to an acceptable level.

Financial Statements Audit Clients that are Not Listed Entities

290.170 The firm, or a network firm, may provide a financial statement audit client that is not a listed entity with accounting and bookkeeping services, including payroll services, of a routine or mechanical nature, provided any self-review threat created is reduced to an acceptable level. Examples of such services include:

- Recording transactions for which the audit client has determined or approved the appropriate account classification;
- Posting coded transactions to the audit client's general ledger;
- Preparing financial statements based on information in the trial balance; and
- Posting the audit client approved entries to the trial balance.

The significance of any threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Making arrangements so such services are not performed by a member of the assurance team;
- Implementing policies and procedures to prohibit the individual providing such services from making any managerial decisions on behalf of the audit client;
- Requiring the source data for the accounting entries to be originated by the audit client;

- Requiring the underlying assumptions to be originated and approved by the audit client; or
- Obtaining audit client approval for any proposed journal entries or other changes affecting the financial statements.

Financial Statement Audit Clients that are Listed Entities

290.171 The provision of accounting and bookkeeping services, including payroll services and the preparation of financial statements or financial information which forms the basis of the financial statements on which the audit report is provided, on behalf of a financial statement audit client that is a listed entity, may impair the independence of the firm or network firm, or at least give the appearance of impairing independence. Accordingly, no safeguard other than the prohibition of such services, except in emergency situations and when the services fall within the statutory audit mandate, could reduce the threat created to an acceptable level. Therefore, a firm or a network firm should not, with the limited exceptions below, provide such services to a listed entity that is a financial statement audit client.

290.172 The provision of accounting and bookkeeping services of a routine or mechanical nature to divisions or subsidiaries of a financial statement audit client that is a listed entity would not be seen as impairing independence with respect to the audit client provided that the following conditions are met:

(a) The services do not involve the exercise of judgment.

(b) The divisions or subsidiaries for which the service is provided are collectively immaterial to the audit client, or the services provided are collectively immaterial to the division or subsidiary.

(c) The fees to the firm, or network firm, from such services are collectively clearly insignificant.

If such services are provided, all of the following safeguards should be applied:

(a) The firm, or network firm, should not assume any managerial role nor make any managerial decisions.

(b) The audit client should accept responsibility for the results of the work.

(c) Personnel providing the services should not participate in the audit.

Emergency Situations

290.173 The provision of accounting and bookkeeping services to financial statement audit clients in emergency or other unusual situations, when it

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is impractical for the audit client to make other arrangements, would not be considered to pose an unacceptable threat to independence provided:

(a) The firm, or network firm, does not assume any managerial role or make any managerial decisions;

(b) The audit client accepts responsibility for the results of the work; and

(c) Personnel providing the services are not members of the assurance team.

Valuation Services

290.174 A valuation comprises the making of assumptions with regard to future developments, the application of certain methodologies and techniques, and the combination of both in order to compute a certain value, or range of values, for an asset, a liability or for a business as a whole.

290.175 A self-review threat may be created when a firm or network firm performs a valuation for a financial statement audit client that is to be incorporated into the client's financial statements.

290.176 If the valuation service involves the valuation of matters material to the financial statements and the valuation involves a significant degree of subjectivity, the self-review threat created could not be reduced to an acceptable level by the application of any safeguard. Accordingly, such valuation services should not be provided or, alternatively, the only course of action would be to withdraw from the financial statement audit engagement.

290.177 Performing valuation services for a financial statement audit client that are neither separately, nor in the aggregate, material to the financial statements, or that do not involve a significant degree of subjectivity, may create a self-review threat that could be reduced to an acceptable level by the application of safeguards. Such safeguards might include:

- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary;
- Confirming with the audit client their understanding of the underlying assumptions of the valuation and the methodology to be used and obtaining approval for their use;
- Obtaining the audit client's acknowledgement of responsibility for the results of the work performed by the firm; and
- Making arrangements so that personnel providing such services do not participate in the audit engagement.

In determining whether the above safeguards would be effective, consideration should be given to the following matters:

(a) The extent of the audit client's knowledge, experience and ability to evaluate the issues concerned, and the extent of their involvement in determining and approving significant matters of judgment.

(b) The degree to which established methodologies and professional guidelines are applied when performing a particular valuation service.

(c) For valuations involving standard or established methodologies, the degree of subjectivity inherent in the item concerned.

(d) The reliability and extent of the underlying data.

(e) The degree of dependence on future events of a nature which could create significant volatility inherent in the amounts involved.

(f) The extent and clarity of the disclosures in the financial statements.

290.178 When a firm, or a network firm, performs a valuation service for a financial statement audit client for the purposes of making a filing or return to a tax authority, computing an amount of tax due by the client, or for the purpose of tax planning, this would not create a significant threat to independence because such valuations are generally subject to external review, for example by a tax authority.

290.179 When the firm performs a valuation that forms part of the subject matter information of an assurance engagement that is not a financial statement audit engagement, the firm should consider any self-review threats. If the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

Provision of Taxation Services to Financial Statement Audit Clients

290.180 In many jurisdictions, the firm may be asked to provide taxation services to a financial statement audit client. Taxation services comprise a broad range of services, including compliance, planning, provision of formal taxation opinions and assistance in the resolution of tax disputes. Such assignments are generally not seen to create threats to independence.

Provision of Internal Audit Services to Financial Statement Audit Clients

290.181 A self-review threat may be created when a firm, or network firm, provides internal audit services to a financial statement audit client. Internal audit services may comprise an extension of the firm's audit service beyond requirements of generally accepted auditing standards, assistance in the performance of a client's internal audit activities or outsourcing of the activities. In evaluating any threats to independence, the nature of the service will need to be considered. For this purpose, internal audit services do not include operational internal audit services unrelated to the internal accounting controls, financial systems or financial statements.

290.182 Services involving an extension of the procedures required to conduct a financial statement audit in accordance with International Standards on Auditing would not be considered to impair independence with respect to the audit client provided that the firm's or network firm's personnel do not act or appear to act in a capacity equivalent to a member of audit client management.

290.183 When the firm, or a network firm, provides assistance in the performance of a financial statement audit client's internal audit activities or undertakes the outsourcing of some of the activities, any self-review threat created may be reduced to an acceptable level by ensuring that there is a clear separation between the management and control of the internal audit by client management and the internal audit activities themselves.

290.184 Performing a significant portion of the financial statement audit client's internal audit activities may create a self-review threat and a firm, or network firm, should consider the threats and proceed with caution before taking on such activities. Appropriate safeguards should be put in place and the firm, or network firm, should, in particular, ensure that the audit client acknowledges its responsibilities for establishing, maintaining and monitoring the system of internal controls.

290.185 Safeguards that should be applied in all circumstances to reduce any threats created to an acceptable level include ensuring that:

(a) The audit client is responsible for internal audit activities and acknowledges its responsibility for establishing, maintaining and monitoring the system of internal controls;

(b) The audit client designates a competent employee, preferably within senior management, to be responsible for internal audit activities;

(c) The audit client, the audit committee or supervisory body approves the scope, risk and frequency of internal audit work;

(d) The audit client is responsible for evaluating and determining which recommendations of the firm should be implemented;

(e) The audit client evaluates the adequacy of the internal audit procedures performed and the findings resulting from the performance of those procedures by, among other things, obtaining and acting on reports from the firm; and

(f) The findings and recommendations resulting from the internal audit activities are reported appropriately to the audit committee or supervisory body.

290.186 Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the financial statement audit engagement and with different reporting lines within the firm.

Provision of IT Systems Services to Financial Statement Audit Clients

290.187 The provision of services by a firm or network firm to a financial statement audit client that involve the design and implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may create a self-review threat.

290.188 The self-review threat is likely to be too significant to allow the provision of such services to a financial statement audit client unless appropriate safeguards are put in place ensuring that:

(a) The audit client acknowledges its responsibility for establishing and monitoring a system of internal controls;

(b) The audit client designates a competent employee, preferably within senior management, with the responsibility to make all management decisions with respect to the design and implementation of the hardware or software system;

(c) The audit client makes all management decisions with respect to the design and implementation process;

(d) The audit client evaluates the adequacy and results of the design and implementation of the system; and

(e) The audit client is responsible for the operation of the system (hardware or software) and the data used or generated by the system.

290.189 Consideration should also be given to whether such non-assurance services should be provided only by personnel not involved in the financial statement audit engagement and with different reporting lines within the firm.

290.190 The provision of services by a firm, or network firm, to a financial statement audit client which involve either the design or the implementation of financial information technology systems that are used to generate information forming part of a client's financial statements may also create a self-review threat. The significance of the threat, if any, should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level.

290.191 The provision of services in connection with the assessment, design and implementation of internal accounting controls and risk management controls are not considered to create a threat to independence provided that firm or network firm personnel do not perform management functions.

Temporary Staff Assignments to Financial Statement Audit Clients

290.192 The lending of staff by a firm, or network firm, to a financial statement audit client may create a self-review threat when the individual is in a position to influence the preparation of a client's accounts or financial statements. In practice, such assistance may be given (particularly in emergency situations) but only on the understanding that the firm's or network firm's personnel will not be involved in:

(a) Making management decisions;

(b) Approving or signing agreements or other similar documents; or

(c) Exercising discretionary authority to commit the client.

Each situation should be carefully analyzed to identify whether any threats are created and whether appropriate safeguards should be implemented. Safeguards that should be applied in all circumstances to reduce any threats to an acceptable level include:

- The staff providing the assistance should not be given audit responsibility for any function or activity that they performed or supervised during their temporary staff assignment; and
- The audit client should acknowledge its responsibility for directing and supervising the activities of firm, or network firm, personnel.

Provision of Litigation Support Services to Financial Statement Audit Clients

290.193 Litigation support services may include activities such as acting as an expert witness, calculating estimated damages or other amounts that might become receivable or payable as the result of litigation or other legal dispute, and assistance with document management and retrieval in relation to a dispute or litigation.

290.194 A self-review threat may be created when the litigation support services provided to a financial statement audit client include the estimation of the possible outcome and thereby affects the amounts or disclosures to be reflected in the financial statements. The significance of any threat created will depend upon factors such as:

- The materiality of the amounts involved;

- The degree of subjectivity inherent in the matter concerned; and
- The nature of the engagement.

The firm, or network firm, should evaluate the significance of any threat created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Policies and procedures to prohibit individuals assisting the audit client from making managerial decisions on behalf of the client;
- Using professionals who are not members of the assurance team to perform the service; or
- The involvement of others, such as independent experts.

290.195 If the role undertaken by the firm or network firm involved making managerial decisions on behalf of the financial statement audit client, the threats created could not be reduced to an acceptable level by the application of any safeguard. Therefore, the firm or network firm should not perform this type of service for an audit client.

Provision of Legal Services to Financial Statement Audit Clients

290.196 Legal services are defined as any services for which the person providing the services must either be admitted to practice before the Courts of the jurisdiction in which such services are to be provided, or have the required legal training to practice law. Legal services encompass a wide and diversified range of areas including both corporate and commercial services to clients, such as contract support, litigation, mergers and acquisition advice and support and the provision of assistance to clients' internal legal departments. The provision of legal services by a firm, or network firm, to an entity that is a financial statement audit client may create both self-review and advocacy threats.

290.197 Threats to independence need to be considered depending on the nature of the service to be provided, whether the service provider is separate from the assurance team and the materiality of any matter in relation to the entities' financial statements. The safeguards set out in paragraph 290.162 may be appropriate in reducing any threats to independence to an acceptable level. In circumstances when the threat to independence cannot be reduced to an acceptable level the only available action is to decline to provide such services or withdraw from the financial statement audit engagement.

290.198 The provision of legal services to a financial statement audit client which involve matters that would not be expected to have a material effect on the financial statements are not considered to create an unacceptable threat to independence.

290.199 There is a distinction between advocacy and advice. Legal services to support a financial statement audit client in the execution of a transaction (e.g., contract support, legal advice, legal due diligence and restructuring) may create self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Such a service would not generally impair independence, provided that:

(a) Members of the assurance team are not involved in providing the service; and

(b) In relation to the advice provided, the audit client makes the ultimate decision or, in relation to the transactions, the service involves the execution of what has been decided by the audit client.

290.200 Acting for a financial statement audit client in the resolution of a dispute or litigation in such circumstances when the amounts involved are material in relation to the financial statements of the audit client would create advocacy and self-review threats so significant no safeguard could reduce the threat to an acceptable level. Therefore, the firm should not perform this type of service for a financial statement audit client.

290.201 When a firm is asked to act in an advocacy role for a financial statement audit client in the resolution of a dispute or litigation in circumstances when the amounts involved are not material to the financial statements of the audit client, the firm should evaluate the significance of any advocacy and self-review threats created and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate the threat or reduce it to an acceptable level. Such safeguards might include:

- Policies and procedures to prohibit individuals assisting the audit client from making managerial decisions on behalf of the client; or
- Using professionals who are not members of the assurance team to perform the service.

290.202 The appointment of a partner or an employee of the firm or network firm as General Counsel for legal affairs to a financial statement audit client would create self-review and advocacy threats that are so significant no safeguards could reduce the threats to an acceptable level. The position of General Counsel is generally a senior management position with broad responsibility for the legal affairs of a company and consequently, no member of the firm or network firm should accept such an appointment for a financial statement audit client.

Recruiting Senior Management

290.203 The recruitment of senior management for an assurance client, such as those in a position to affect the subject matter information of the assurance engagement, may create current or future self-interest, familiarity and intimidation threats. The significance of the threat will depend upon factors such as:

- The role of the person to be recruited; and
- The nature of the assistance sought.

The firm could generally provide such services as reviewing the professional qualifications of a number of applicants and provide advice on their suitability for the post. In addition, the firm could generally produce a short-list of candidates for interview, provided it has been drawn up using criteria specified by the assurance client.

The significance of the threat created should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. In all cases, the firm should not make management decisions and the decision as to whom to hire should be left to the client.

Corporate Finance and Similar Activities

290.204 The provision of corporate finance services, advice or assistance to an assurance client may create advocacy and self-review threats. In the case of certain corporate finance services, the independence threats created would be so significant no safeguards could be applied to reduce the threats to an acceptable level. For example, promoting, dealing in, or underwriting of an assurance client's shares is not compatible with providing assurance services. Moreover, committing the assurance client to the terms of a transaction or consummating a transaction on behalf of the client would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level. In the case of a financial statement audit client the provision of those corporate finance services referred to above by a firm or a network firm would create a threat to independence so significant no safeguard could reduce the threat to an acceptable level.

290.205 Other corporate finance services may create advocacy or self-review threats; however, safeguards may be available to reduce these threats to an acceptable level. Examples of such services include assisting a client in developing corporate strategies, assisting in identifying or introducing a client to possible sources of capital that meet the client specifications or criteria, and providing structuring advice and assisting a client in analyzing the accounting effects of proposed transactions. Safeguards that should be considered include:

- Policies and procedures to prohibit individuals assisting the assurance client from making managerial decisions on behalf of the client;
- Using professionals who are not members of the assurance team to provide the services; and
- Ensuring the firm does not commit the assurance client to the terms of any transaction or consummate a transaction on behalf of the client.

Fees and Pricing

Fees—Relative Size

290.206 When the total fees generated by an assurance client represent a large proportion of a firm's total fees, the dependence on that client or client group and concern about the possibility of losing the client may create a self-interest threat. The significance of the threat will depend upon factors such as:

- The structure of the firm; and
- Whether the firm is well established or newly created.

The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Discussing the extent and nature of fees charged with the audit committee, or others charged with governance;
- Taking steps to reduce dependency on the client;
- External quality control reviews; and
- Consulting a third party, such as a professional regulatory body or another professional accountant.

290.207 A self-interest threat may also be created when the fees generated by the assurance client represent a large proportion of the revenue of an individual partner. The significance of the threat should be evaluated and, if the threat is other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threat to an acceptable level. Such safeguards might include:

- Policies and procedures to monitor and implement quality control of assurance engagements; and

- Involving an additional professional accountant who was not a member of the assurance team to review the work done or otherwise advise as necessary.

Fees—Overdue

290.208 A self-interest threat may be created if fees due from an assurance client for professional services remain unpaid for a long time, especially if a significant part is not paid before the issue of the assurance report for the following year. Generally the payment of such fees should be required before the report is issued. The following safeguards may be applicable:

- Discussing the level of outstanding fees with the audit committee, or others charged with governance.
- Involving an additional professional accountant who did not take part in the assurance engagement to provide advice or review the work performed.

The firm should also consider whether the overdue fees might be regarded as being equivalent to a loan to the client and whether, because of the significance of the overdue fees, it is appropriate for the firm to be re-appointed.

Pricing

290.209 When a firm obtains an assurance engagement at a significantly lower fee level than that charged by the predecessor firm, or quoted by other firms, the self-interest threat created will not be reduced to an acceptable level unless:

(a) The firm is able to demonstrate that appropriate time and qualified staff are assigned to the task; and

(b) All applicable assurance standards, guidelines and quality control procedures are being complied with.

Contingent Fees

290.210 Contingent fees are fees calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed. For the purposes of this section, fees are not regarded as being contingent if a court or other public authority has established them.

290.211 A contingent fee charged by a firm in respect of an assurance engagement creates self-interest and advocacy threats that cannot be reduced to an acceptable level by the application of any safeguard. Accordingly, a firm should not enter into any fee arrangement for an assurance engagement under which the amount of the fee is contingent on the result of the assurance work or on items that are the subject matter information of the assurance engagement.

290.212 A contingent fee charged by a firm in respect of a non-assurance service provided to an assurance client may also create self-interest and advocacy threats. If the amount of the fee for a non-assurance engagement was agreed to, or contemplated, during an assurance engagement and was contingent on the result of that assurance engagement, the threats could not be reduced to an acceptable level by the application of any safeguard. Accordingly, the only acceptable action is not to accept such arrangements. For other types of contingent fee arrangements, the significance of the threats created will depend on factors such as:

- The range of possible fee amounts;
- The degree of variability;
- The basis on which the fee is to be determined;
- Whether the outcome or result of the transaction is to be reviewed by an independent third party; and
- The effect of the event or transaction on the assurance engagement.

The significance of the threats should be evaluated and, if the threats are other than clearly insignificant, safeguards should be considered and applied as necessary to reduce the threats to an acceptable level. Such safeguards might include:

- Disclosing to the audit committee, or others charged with governance, the extent and nature of fees charged;
- Review or determination of the final fee by an unrelated third party; or
- Quality and control policies and procedures.

Gifts and Hospitality

290.213 Accepting gifts or hospitality from an assurance client may create self-interest and familiarity threats. When a firm or a member of the assurance team accepts gifts or hospitality, unless the value is clearly insignificant, the threats to independence cannot be reduced to an acceptable level by the application of any safeguard. Consequently, a firm or a member of the assurance team should not accept such gifts or hospitality.

Actual or Threatened Litigation

290.214 When litigation takes place, or appears likely, between the firm or a member of the assurance team and the assurance client, a self-interest or intimidation threat may be created. The relationship between client management and the members of the assurance team must be characterized by complete candor and full disclosure regarding all aspects of a client's business operations. The firm and the client's management may be placed in adversarial positions by litigation, affecting management's willingness to make complete disclosures and the firm may face a self-interest threat. The significance of the threat created will depend upon such factors as:

- The materiality of the litigation;
- The nature of the assurance engagement; and
- Whether the litigation relates to a prior assurance engagement.

Once the significance of the threat has been evaluated the following safeguards should be applied, if necessary, to reduce the threats to an acceptable level:

(a) Disclosing to the audit committee, or others charged with governance, the extent and nature of the litigation;

(b) If the litigation involves a member of the assurance team, removing that individual from the assurance team; or

(c) Involving an additional professional accountant in the firm who was not a member of the assurance team to review the work done or otherwise advise as necessary.

If such safeguards do not reduce the threat to an appropriate level, the only appropriate action is to withdraw from, or refuse to accept, the assurance engagement.

Section 290 Interpretations

These interpretations are directed towards the application of the IFAC *Code of Ethics for Professional Accountants* to the topics of the specific queries received. Those subject to the regulations of other authoritative bodies, such as the US Securities and Exchange Commission, may wish to consult with them for their positions on these matters.

Interpretation 2003-01

The Provision of Non-Assurance Services to Assurance Clients

The *Code of Ethics for Professional Accountants* addresses the issue of the provision of non assurance services to assurance clients in paragraphs 290.158–290.205 inclusive. The Code does not currently include any transitional provisions relating to the requirements set out in these paragraphs however the Ethics Committee[5] has concluded that it is appropriate to allow a transitional period of one year, during which existing contracts to provide non assurance services for assurance clients may be completed if additional safeguards are put in place to reduce any threat to independence to an insignificant level. This transitional period commences on December 31, 2004 (or from the date of implementation of the Code for members of those IFAC member bodies which have adopted an earlier implementation date).

Interpretation 2003-02

Lead Engagement Partner Rotation for Audit Clients that are Listed Entities

The *Code of Ethics for Professional Accountants* addresses the issue of engagement partner rotation for financial statement audit clients that are listed entities in paragraphs 290.154–290.157.

The paragraphs state that in the financial statement audit of a listed entity the engagement partner should be rotated after serving in that capacity for a pre-defined period, normally no more than seven years. They also state that some degree of flexibility in timing of rotation may be necessary in certain circumstances. The Ethics Committee[6] believes that the implementation (or early adoption) of the Code constitutes an example of a circumstance in which some degree of flexibility over timing of rotation may be necessary.

The Code does not currently include any transitional provisions relating to these requirements. However, the Ethics Committee[7] has concluded that it is appropriate to allow a transitional period of two years. Consequently, on implementation or early adoption of the Code, while the length of time the engagement partner has served the financial statement audit client in that capacity should be considered in determining

5 Now referred to as the International Ethics Standards Board for Accountants.

6 See footnote 5.

7 See footnote 5.

when rotation should occur, the partner may continue to serve as the engagement partner for two additional years from the date of implementation (or early adoption) before rotating off the engagement. In such circumstances, the additional requirements of paragraph 290.157 to apply equivalent safeguards in order to reduce any threats to an acceptable level should be followed.

Interpretation 2005-01

Application of Section 290 to Assurance Engagements that are Not Financial Statement Audit Engagements

This interpretation provides guidance on the application of the independence requirements contained in Section 290 to assurance engagements that are not financial statement audit engagements.

This interpretation focuses on the application issues that are particular to assurance engagements that are not financial statement audit engagements. There are other matters noted in Section 290 that are relevant in the consideration of independence requirements for all assurance engagements. For example, paragraph 290.28 states that consideration should be given to any threats the firm has reason to believe may be created by network firms' interests and relationships. Similarly, paragraph 290.34 states that for assurance clients, that are other than listed entity financial statement audit clients, when the assurance team has reason to believe that a related entity of such an assurance client is relevant to the evaluation of the firm's independence of the client, the assurance team should consider that related entity when evaluating independence and applying appropriate safeguards. These matters are not specifically addressed in this interpretation.

As explained in the International Framework for Assurance Engagements issued by the International Auditing and Assurance Standards Board, in an assurance engagement, the professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

Assertion-Based Assurance Engagements

In an assertion-based assurance engagement, the evaluation or measurement of the subject matter is performed by the responsible party, and the subject matter information is in the form of an assertion by the responsible party that is made available to the intended users.

In an assertion-based assurance engagement independence is required from the responsible party, which is responsible for the subject matter information and may be responsible for the subject matter.

In those assertion-based assurance engagements where the responsible party is responsible for the subject matter information but not the subject matter, independence is required from the responsible party. In addition, consideration should be given to any threats the firm has reason to believe may be created by interests and relationships between a member of the assurance team, the firm, a network firm and the party responsible for the subject matter.

Direct Reporting Assurance Engagements

In a direct reporting assurance engagement, the professional accountant in public practice either directly performs the evaluation or measurement of the subject matter, or obtains a representation from the responsible party that has performed the evaluation or measurement that is not available to the intended users. The subject matter information is provided to the intended users in the assurance report.

In a direct reporting assurance engagement independence is required from the responsible party, which is responsible for the subject matter.

Multiple Responsible Parties

In both assertion-based assurance engagements and direct reporting assurance engagements there may be several responsible parties. For example, a public accountant in public practice may be asked to provide assurance on the monthly circulation statistics of a number of independently owned newspapers. The assignment could be an assertion based assurance engagement where each newspaper measures its circulation and the statistics are presented in an assertion that is available to the intended users. Alternatively, the assignment could be a direct reporting assurance engagement, where there is no assertion and there may or may not be a written representation from the newspapers.

In such engagements, when determining whether it is necessary to apply the provisions in Section 290 to each responsible party, the firm may take into account whether an interest or relationship between the firm, or a member of the assurance team, and a particular responsible party would create a threat to independence that is other than clearly insignificant in the context of the subject matter information. This will take into account:

- The materiality of the subject matter information (or the subject matter) for which the particular responsible party is responsible; and
- The degree of public interest that is associated with the engagement.

If the firm determines that the threat to independence created by any such relationships with a particular responsible party would be clearly insignificant it may not be necessary to apply all of the provisions of this section to that responsible party.

Example

The following example has been developed to demonstrate the application of Section 290. It is assumed that the client is not also a financial statement audit client of the firm, or a network firm.

A firm is engaged to provide assurance on the total proven oil reserves of 10 independent companies. Each company has conducted geographical and engineering surveys to determine their reserves (subject matter). There are established criteria to determine when a reserve may be considered to be proven which the professional accountant in public practice determines to be suitable criteria for the engagement.

The proven reserves for each company as at December 31, 20X0 were as follows:

	Proven oil reserves thousands of barrels
Company 1	5,200
Company 2	725
Company 3	3,260
Company 4	15,000
Company 5	6,700
Company 6	39,126
Company 7	345
Company 8	175
Company 9	24,135
Company 10	9,635
Total	**104,301**

The engagement could be structured in differing ways:

Assertion-Based Engagements

A1 Each company measures its reserves and provides an assertion to the firm and to intended users.

A2 An entity other than the companies measures the reserves and provides an assertion to the firm and to intended users.

Direct Reporting Engagements

D1 Each company measures the reserves and provides the firm with a written representation that measures its reserves against the established criteria for measuring proven reserves. The representation is not available to the intended users.

D2 The firm directly measures the reserves of some of the companies.

Application of Approach

A1 Each company measures its reserves and provides an assertion to the firm and to intended users.

There are several responsible parties in this engagement (companies 1-10). When determining whether it is necessary to apply the independence provisions to all of the companies, the firm may take into account whether an interest or relationship with a particular company would create a threat to independence that is other than clearly insignificant. This will take into account factors such as:

- The materiality of the company's proven reserves in relation to the total reserves to be reported on; and
- The degree of public interest associated with the engagement. (Paragraph 290.33.)

For example Company 8 accounts for 0.16% of the total reserves, therefore a business relationship or interest with Company 8 would create less of a threat than a similar relationship with Company 6, which accounts for approximately 37.5% of the reserves.

Having determined those companies to which the independence requirements apply, the assurance team and the firm are required to be independent of those responsible parties which would be considered to be the assurance client (paragraph 290.33).

A2 An entity other than the companies measures the reserves and provides an assertion to the firm and to intended users.

The firm would be required to be independent of the entity that measures the reserves and provides an assertion to the firm and to intended users (paragraph 290.30). That entity is not responsible for the subject matter and so consideration should be given to any threats the firm has reason to believe may be created by interests/relationships with the party responsible for the subject matter (paragraph 290.30). There are several parties responsible for subject matter in this engagement (Companies 1-10) As discussed in example A1 above, the firm may take into account whether an interest or relationship with a particular company would create a threat to independence that is other than clearly insignificant.

D1 Each company provides the firm with a representation that measures its reserves against the established criteria for measuring proven reserves. The representation is not available to the intended users.

There are several responsible parties in this engagement (Companies 1-10). When determining whether it is necessary to apply the independence provisions to all of the companies, the firm may take into account whether an interest or relationship with a particular company would create a threat to independence that is other than clearly insignificant. This will take into account factors such as:

- The materiality of the company's proven reserves in relation to the total reserves to be reported on; and
- The degree of public interest associated with the engagement. (paragraph 290.33).

For example Company 8 accounts for 0.16% of the reserves, therefore a business relationship or interest with Company 8 would create less of a threat than a similar relationship with Company 6 that accounts for approximately 37.5% of the reserves.

Having determined those companies to which the independence requirements apply, the assurance team and the firm are required to be independent of those responsible parties which would be considered to be the assurance client (paragraph 290.33).

D2 The firm directly measures the reserves of some of the companies.

The application is the same as in example D1.

PART C—PROFESSIONAL ACCOUNTANTS IN BUSINESS

SECTION 300

Introduction

300.1 This Part of the Code illustrates how the conceptual framework contained in Part A is to be applied by professional accountants in business.

300.2 Investors, creditors, employers and other sectors of the business community, as well as governments and the public at large, all may rely on the work of professional accountants in business. Professional accountants in business may be solely or jointly responsible for the preparation and reporting of financial and other information, which both their employing organizations and third parties may rely on. They may also be responsible for providing effective financial management and competent advice on a variety of business-related matters.

300.3 A professional accountant in business may be a salaried employee, a partner, director (whether executive or non-executive), an owner manager, a volunteer or another working for one or more employing organization. The legal form of the relationship with the employing organization, if any, has no bearing on the ethical responsibilities incumbent on the professional accountant in business.

300.4 A professional accountant in business has a responsibility to further the legitimate aims of their employing organization. This Code does not seek to hinder a professional accountant in business from properly fulfilling that responsibility, but considers circumstances in which conflicts may be created with the absolute duty to comply with the fundamental principles.

300.5 A professional accountant in business often holds a senior position within an organization. The more senior the position, the greater will be the ability and opportunity to influence events, practices and attitudes. A professional accountant in business is expected, therefore, to encourage an ethics-based culture in an employing organization that emphasizes the importance that senior management places on ethical behavior.

300.6 The examples presented in the following sections are intended to illustrate how the conceptual framework is to be applied and are not intended to be, nor should they be interpreted as, an exhaustive list of all circumstances experienced by a professional accountant in business that may create threats to compliance with the principles. Consequently, it is not sufficient for a professional accountant in business merely to comply with the examples; rather, the framework should be applied to the particular circumstances faced.

Threats and Safeguards

300.7 Compliance with the fundamental principles may potentially be threatened by a broad range of circumstances. Many threats fall into the following categories:

(a) Self-interest;

(b) Self-review;

(c) Advocacy;

(d) Familiarity; and

(e) Intimidation.

These threats are discussed further in Part A of this Code.

300.8 Examples of circumstances that may create self-interest threats for a professional accountant in business include, but are not limited to:

- Financial interests, loans or guarantees.
- Incentive compensation arrangements.
- Inappropriate personal use of corporate assets.
- Concern over employment security.
- Commercial pressure from outside the employing organization.

300.9 Circumstances that may create self-review threats include, but are not limited to, business decisions or data being subject to review and justification by the same professional accountant in business responsible for making those decisions or preparing that data.

300.10 When furthering the legitimate goals and objectives of their employing organizations professional accountants in business may promote the organization’s position, provided any statements made are neither false nor misleading. Such actions generally would not create an advocacy threat.

300.11 Examples of circumstances that may create familiarity threats include, but are not limited to:

- A professional accountant in business in a position to influence financial or non-financial reporting or business decisions having an immediate or close family member who is in a position to benefit from that influence.
- Long association with business contacts influencing business decisions.
- Acceptance of a gift or preferential treatment, unless the value is clearly insignificant.

300.12 Examples of circumstances that may create intimidation threats include, but are not limited to:

- Threat of dismissal or replacement of the professional accountant in business or a close or immediate family member over a disagreement about the application of an accounting principle or the way in which financial information is to be reported.
- A dominant personality attempting to influence the decision making process, for example with regard to the awarding of contracts or the application of an accounting principle.

300.13 Professional accountants in business may also find that specific circumstances give rise to unique threats to compliance with one or more of the fundamental principles. Such unique threats obviously cannot be categorized. In all professional and business relationships, professional accountants in business should always be on the alert for such circumstances and threats.

300.14 Safeguards that may eliminate or reduce to an acceptable level the threats faced by professional accountants in business fall into two broad categories:

(a) Safeguards created by the profession, legislation or regulation; and

(b) Safeguards in the work environment.

300.15 Examples of safeguards created by the profession, legislation or regulation are detailed in paragraph 100.12 of Part A of this Code.

300.16 Safeguards in the work environment include, but are not restricted to:

- The employing organization's systems of corporate oversight or other oversight structures.
- The employing organization's ethics and conduct programs.
- Recruitment procedures in the employing organization emphasizing the importance of employing high caliber competent staff.
- Strong internal controls.
- Appropriate disciplinary processes.
- Leadership that stresses the importance of ethical behavior and the expectation that employees will act in an ethical manner.
- Policies and procedures to implement and monitor the quality of employee performance.
- Timely communication of the employing organization's policies and procedures, including any changes to them, to all employees and appropriate training and education on such policies and procedures.

- Policies and procedures to empower and encourage employees to communicate to senior levels within the employing organization any ethical issues that concern them without fear of retribution.
- Consultation with another appropriate professional accountant.

300.17 In circumstances where a professional accountant in business believes that unethical behavior or actions by others will continue to occur within the employing organization, the professional accountant in business should consider seeking legal advice. In those extreme situations where all available safeguards have been exhausted and it is not possible to reduce the threat to an acceptable level, a professional accountant in business may conclude that it is appropriate to resign from the employing organization.

SECTION 310

Potential Conflicts

310.1 A professional accountant in business has a professional obligation to comply with the fundamental principles. There may be times, however, when their responsibilities to an employing organization and the professional obligations to comply with the fundamental principles are in conflict. Ordinarily, a professional accountant in business should support the legitimate and ethical objectives established by the employer and the rules and procedures drawn up in support of those objectives. Nevertheless, where compliance with the fundamental principles is threatened, a professional accountant in business must consider a response to the circumstances.

310.2 As a consequence of responsibilities to an employing organization, a professional accountant in business may be under pressure to act or behave in ways that could directly or indirectly threaten compliance with the fundamental principles. Such pressure may be explicit or implicit; it may come from a supervisor, manager, director or another individual within the employing organization. A professional accountant in business may face pressure to:

- Act contrary to law or regulation.
- Act contrary to technical or professional standards.
- Facilitate unethical or illegal earnings management strategies.
- Lie to, or otherwise intentionally mislead (including misleading by remaining silent) others, in particular:
  - The auditors of the employing organization; or
  - Regulators.
- Issue, or otherwise be associated with, a financial or non-financial report that materially misrepresents the facts, including statements in connection with, for example:
  - The financial statements;
  - Tax compliance;
  - Legal compliance; or
  - Reports required by securities regulators.

310.3 The significance of threats arising from such pressures, such as intimidation threats, should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include:

- Obtaining advice where appropriate from within the employing organization, an independent professional advisor or a relevant professional body.
- The existence of a formal dispute resolution process within the employing organization.
- Seeking legal advice.

SECTION 320

Preparation and Reporting of Information

320.1 Professional accountants in business are often involved in the preparation and reporting of information that may either be made public or used by others inside or outside the employing organization. Such information may include financial or management information, for example, forecasts and budgets, financial statements, management discussion and analysis, and the management letter of representation provided to the auditors as part of an audit of financial statements. A professional accountant in business should prepare or present such information fairly, honestly and in accordance with relevant professional standards so that the information will be understood in its context.

320.2 A professional accountant in business who has responsibility for the preparation or approval of the general purpose financial statements of an employing organization should ensure that those financial statements are presented in accordance with the applicable financial reporting standards.

320.3 A professional accountant in business should maintain information for which the professional accountant in business is responsible in a manner that:

(a) Describes clearly the true nature of business transactions, assets or liabilities;

(b) Classifies and records information in a timely and proper manner; and

(c) Represents the facts accurately and completely in all material respects.

320.4 Threats to compliance with the fundamental principles, for example self-interest or intimidation threats to objectivity or professional competence and due care, may be created where a professional accountant in business may be pressured (either externally or by the possibility of personal gain) to become associated with misleading information or to become associated with misleading information through the actions of others.

320.5 The significance of such threats will depend on factors such as the source of the pressure and the degree to which the information is, or may be, misleading. The significance of the threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Such safeguards may include consultation with superiors within the employing organization, for example, the audit committee or other body responsible for governance, or with a relevant professional body.

320.6 Where it is not possible to reduce the threat to an acceptable level, a professional accountant in business should refuse to remain associated with information they consider is or may be misleading. Should the professional accountant in business be aware that the issuance of misleading information is either significant or persistent, the professional accountant in business should consider informing appropriate authorities in line with the guidance in Section 140. The professional accountant in business may also wish to seek legal advice or resign.

SECTION 330

Acting with Sufficient Expertise

330.1 The fundamental principle of professional competence and due care requires that a professional accountant in business should only undertake significant tasks for which the professional accountant in business has, or can obtain, sufficient specific training or experience. A professional accountant in business should not intentionally mislead an employer as to the level of expertise or experience possessed, nor should a professional accountant in business fail to seek appropriate expert advice and assistance when required.

330.2 Circumstances that threaten the ability of a professional accountant in business to perform duties with the appropriate degree of professional competence and due care include:

- Insufficient time for properly performing or completing the relevant duties.
- Incomplete, restricted or otherwise inadequate information for performing the duties properly.
- Insufficient experience, training and/or education.
- Inadequate resources for the proper performance of the duties.

330.3 The significance of such threats will depend on factors such as the extent to which the professional accountant in business is working with others, relative seniority in the business and the level of supervision and review applied to the work. The significance of the threats should be evaluated and, if they are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. Safeguards that may be considered include:

- Obtaining additional advice or training.
- Ensuring that there is adequate time available for performing the relevant duties.
- Obtaining assistance from someone with the necessary expertise.
- Consulting, where appropriate, with:
    - Superiors within the employing organization;
    - Independent experts; or
    - A relevant professional body.

330.4 Where threats cannot be eliminated or reduced to an acceptable level, professional accountants in business should consider whether to refuse to

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perform the duties in question. If the professional accountant in business determines that refusal is appropriate the reasons for doing so should be clearly communicated.

SECTION 340

Financial Interests

340.1 Professional accountants in business may have financial interests, or may know of financial interests of immediate or close family members, that could, in certain circumstances, give rise to threats to compliance with the fundamental principles. For example, self-interest threats to objectivity or confidentiality may be created through the existence of the motive and opportunity to manipulate price sensitive information in order to gain financially. Examples of circumstances that may create self-interest threats include, but are not limited to situations where the professional accountant in business or an immediate or close family member:

- Holds a direct or indirect financial interest in the employing organization and the value of that financial interest could be directly affected by decisions made by the professional accountant in business;
- Is eligible for a profit related bonus and the value of that bonus could be directly affected by decisions made by the professional accountant in business;
- Holds, directly or indirectly, share options in the employing organization, the value of which could be directly affected by decisions made by the professional accountant in business;
- Holds, directly or indirectly, share options in the employing organization which are, or will soon be, eligible for conversion; or
- May qualify for share options in the employing organization or performance related bonuses if certain targets are achieved.

340.2 In evaluating the significance of such a threat, and the appropriate safeguards to be applied to eliminate the threat or reduce it to an acceptable level, professional accountants in business must examine the nature of the financial interest. This includes an evaluation of the significance of the financial interest and whether it is direct or indirect. Clearly, what constitutes a significant or valuable stake in an organization will vary from individual to individual, depending on personal circumstances.

340.3 If threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate or reduce them to an acceptable level. Such safeguards may include:

- Policies and procedures for a committee independent of management to determine the level of form of remuneration of senior management.

- Disclosure of all relevant interests, and of any plans to trade in relevant shares to those charged with the governance of the employing organization, in accordance with any internal policies.
- Consultation, where appropriate, with superiors within the employing organization.
- Consultation, where appropriate, with those charged with the governance of the employing organization or relevant professional bodies.
- Internal and external audit procedures.
- Up-to-date education on ethical issues and the legal restrictions and other regulations around potential insider trading.

340.4 A professional accountant in business should neither manipulate information nor use confidential information for personal gain.

SECTION 350

Inducements

Receiving Offers

350.1 A professional accountant in business or an immediate or close family member may be offered an inducement. Inducements may take various forms, including gifts, hospitality, preferential treatment and inappropriate appeals to friendship or loyalty.

350.2 Offers of inducements may create threats to compliance with the fundamental principles. When a professional accountant in business or an immediate or close family member is offered an inducement, the situation should be carefully considered. Self-interest threats to objectivity or confidentiality are created where an inducement is made in an attempt to unduly influence actions or decisions, encourage illegal or dishonest behavior or obtain confidential information. Intimidation threats to objectivity or confidentiality are created if such an inducement is accepted and it is followed by threats to make that offer public and damage the reputation of either the professional accountant in business or an immediate or close family member.

350.3 The significance of such threats will depend on the nature, value and intent behind the offer. If a reasonable and informed third party, having knowledge of all relevant information, would consider the inducement insignificant and not intended to encourage unethical behavior, then a professional accountant in business may conclude that the offer is made in the normal course of business and may generally conclude that there is no significant threat to compliance with the fundamental principles.

350.4 If evaluated threats are other than clearly insignificant, safeguards should be considered and applied as necessary to eliminate them or reduce them to an acceptable level. When the threats cannot be eliminated or reduced to an acceptable level through the application of safeguards, a professional accountant in business should not accept the inducement. As the real or apparent threats to compliance with the fundamental principles do not merely arise from acceptance of an inducement but, sometimes, merely from the fact of the offer having been made, additional safeguards should be adopted. A professional accountant in business should assess the risk associated with all such offers and consider whether the following actions should be taken:

(a) Where such offers have been made, immediately inform higher levels of management or those charged with governance of the employing organization;

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(b) Inform third parties of the offer – for example, a professional body or the employer of the individual who made the offer; a professional accountant in business should, however, consider seeking legal advice before taking such a step; and

(c) Advise immediate or close family members of relevant threats and safeguards where they are potentially in positions that might result in offers of inducements, for example as a result of their employment situation; and

(d) Inform higher levels of management or those charged with governance of the employing organization where immediate or close family members are employed by competitors or potential suppliers of that organization.

Making Offers

350.5 A professional accountant in business may be in a situation where the professional accountant in business is expected to, or is under other pressure to, offer inducements to subordinate the judgment of another individual or organization, influence a decision-making process or obtain confidential information.

350.6 Such pressure may come from within the employing organization, for example, from a colleague or superior. It may also come from an external individual or organization suggesting actions or business decisions that would be advantageous to the employing organization possibly influencing the professional accountant in business improperly.

350.7 A professional accountant in business should not offer an inducement to improperly influence professional judgment of a third party.

350.8 Where the pressure to offer an unethical inducement comes from within the employing organization, the professional accountant should follow the principles and guidance regarding ethical conflict resolution set out in Part A of this Code.

DEFINITIONS

In this *Code of Ethics for Professional Accountants* the following expressions have the following meanings assigned to them:

Advertising

The communication to the public of information as to the services or skills provided by professional accountants in public practice with a view to procuring professional business.

Assurance client

The responsible party that is the person (or persons) who:

(a) In a direct reporting engagement, is responsible for the subject matter; or

(b) In an assertion-based engagement, is responsible for the subject matter information and may be responsible for the subject matter.

(For an assurance client that is a financial statement audit client see the definition of financial statement audit client.)

Assurance engagement

An engagement in which a professional accountant in public practice expresses a conclusion designed to enhance the degree of confidence of the intended users other than the responsible party about the outcome of the evaluation or measurement of a subject matter against criteria.

(For guidance on assurance engagements see the International Framework for Assurance Engagements issued by the International Auditing and Assurance Standards Board which describes the elements and objectives of an assurance engagement and identifies engagements to which International Standards on Auditing (ISAs), International Standards on Review Engagements (ISREs) and International Standards on Assurance Engagements (ISAEs) apply.)

Assurance team

(a) All members of the engagement team for the assurance engagement;

(b) All others within a firm who can directly influence the outcome of the assurance engagement, including:

(i) Those who recommend the compensation of, or who provide direct supervisory, management or other oversight of the assurance engagement partner in connection with the performance of the assurance engagement. For the purposes of a financial statement audit engagement this includes those at all successively senior levels above the engagement partner through the firm's chief executive;

(ii) Those who provide consultation regarding technical or industry specific issues, transactions or events for the assurance engagement; and

(iii) Those who provide quality control for the assurance engagement, including those who perform the engagement quality control review for the assurance engagement; and

(c) For the purposes of a financial statement audit client, all those within a network firm who can directly influence the outcome of the financial statement audit engagement.

Clearly insignificant A matter that is deemed to be both trivial and inconsequential.

Close family A parent, child or sibling, who is not an immediate family member.

Contingent fee A fee calculated on a predetermined basis relating to the outcome or result of a transaction or the result of the work performed. A fee that is established by a court or other public authority is not a contingent fee.

Direct financial interest A financial interest:

- Owned directly by and under the control of an individual or entity (including those managed on a discretionary basis by others); or
- Beneficially owned through a collective investment vehicle, estate, trust or other

intermediary over which the individual or entity has control.

Director or officer	Those charged with the governance of an entity, regardless of their title, which may vary from country to country.
Engagement partner	The partner or other person in the firm who is responsible for the engagement and its performance, and for the report that is issued on behalf of the firm, and who, where required, has the appropriate authority from a professional, legal or regulatory body.
Engagement quality control review	A process designed to provide an objective evaluation, before the report is issued, of the significant judgments the engagement team made and the conclusions they reached in formulating the report.
Engagement team	All personnel performing an engagement, including any experts contracted by the firm in connection with that engagement.
Existing accountant	A professional accountant in public practice currently holding an audit appointment or carrying out accounting, taxation, consulting or similar professional services for a client.
Financial interest	An interest in an equity or other security, debenture, loan or other debt instrument of an entity, including rights and obligations to acquire such an interest and derivatives directly related to such interest.
Financial statements	The balance sheets, income statements or profit and loss accounts, statements of changes in financial position (which may be presented in a variety of ways, for example, as a statement of cash flows or a statement of fund flows), notes and other statements and explanatory material which are identified as being part of the financial statements.

Financial statement audit client — An entity in respect of which a firm conducts a financial statement audit engagement. When the client is a listed entity, financial statement audit client will always include its related entities.

Financial statement audit engagement — A reasonable assurance engagement in which a professional accountant in public practice expresses an opinion whether financial statements are prepared in all material respects in accordance with an identified financial reporting framework, such as an engagement conducted in accordance with International Standards on Auditing. This includes a Statutory Audit, which is a financial statement audit required by legislation or other regulation.

Firm

(a) A sole practitioner, partnership or corporation of professional accountants;

(b) An entity that controls such parties through ownership, management or other means; and

(c) An entity controlled by such parties through ownership, management or other means.

Immediate family — A spouse (or equivalent) or dependant.

Independence — Independence is:

(a) Independence of mind – the state of mind that permits the provision of an opinion without being affected by influences that compromise professional judgment, allowing an individual to act with integrity, and exercise objectivity and professional skepticism.

(b) Independence in appearance – the avoidance of facts and circumstances that are so significant a reasonable and informed third party, having knowledge of all relevant information, including any safeguards applied, would reasonably conclude a firm's, or a member of the assurance team's, integrity, objectivity or professional skepticism had been compromised.

Indirect financial interest — A financial interest beneficially owned through a collective investment vehicle, estate, trust or other intermediary over which the individual or entity has no control.

Listed entity	An entity whose shares, stock or debt are quoted or listed on a recognized stock exchange, or are marketed under the regulations of a recognized stock exchange or other equivalent body.
Network	A larger structure: (a) That is aimed at co-operation; and (b) That is clearly aimed at profit or cost sharing or shares common ownership, control or management, common quality control policies and procedures, common business strategy, the use of a common brand-name, or a significant part of professional resources.
Network firm	A firm or entity that belongs to a network.
Office	A distinct sub-group, whether organized on geographical or practice lines.
Professional accountant	An individual who is a member of an IFAC member body.
Professional accountant in business	A professional accountant employed or engaged in an executive or non-executive capacity in such areas as commerce, industry, service, the public sector, education, the not for profit sector, regulatory bodies or professional bodies, or a professional accountant contracted by such entities.
Professional accountant in public practice	A professional accountant, irrespective of functional classification (e.g., audit, tax or consulting) in a firm that provides professional services. This term is also used to refer to a firm of professional accountants in public practice.
Professional services	Services requiring accountancy or related skills performed by a professional accountant including accounting, auditing, taxation, management consulting and financial management services.
Related entity	An entity that has any of the following relationships with the client: (a) An entity that has direct or indirect control over the client provided the client is material to such entity;

(b) An entity with a direct financial interest in the client provided that such entity has significant influence over the client and the interest in the client is material to such entity;

(c) An entity over which the client has direct or indirect control;

(d) An entity in which the client, or an entity related to the client under (c) above, has a direct financial interest that gives it significant influence over such entity and the interest is material to the client and its related entity in (c); and

(e) An entity which is under common control with the client (hereinafter a "sister entity") provided the sister entity and the client are both material to the entity that controls both the client and sister entity.

EFFECTIVE DATE

The Code is effective on June 30, 2006. Paragraphs 290.1-290.13 and 290.27-290.47 are applicable to assurance engagements when the assurance report is dated on or after June 30, 2006. Paragraphs 290.14-290.26 are applicable to assurance engagements when the assurance report is dated on or after December 31, 2008.